IN THE

Supreme Court of the United States

October Term, 1977

No. 77-918

THE FIRST NATIONAL BANK OF GLEN HEAD,

Petitioner,

v.

DONALD KATZ, Trustee in Bankruptcy of Oakland Foundry Company of Belleville, Illinois, Inc.,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

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The First National Bank of Glen Head (the "Bank"), the petitioner herein, seeks the issuance of a writ of certiorari to the United States Court of Appeals for the Second Circuit (the "Second Circuit"), reviewing that court's judgment and opinion entered on October 17, 1977.

Opinions Below

The opinion of the Second Circuit, not yet officially reported, appears in Appendix I annexed hereto. The opinion of the United States District Court for the Eastern District of New York, dated October 19, 1976, is officially reported at 424 F.Supp. 1174, and a copy thereof is annexed hereto as Appendix II.*

Jurisdiction

The judgment of the Second Circuit was entered on October 17, 1977, and this petition was filed within 90 days of that date. The Court has jurisdiction pursuant to 28 U.S.C. §1254(1) and Section 24c of the Bankruptcy Act (hereinafter referred to as the "Act"), 11 U.S.C. §47(c).

Questions Presented

1. Whether a unilateral decision by an allegedly insolvent corporate depositor not to exercise its right to draw checks against its general, unrestricted checking account transforms the depository bank, without its knowledge, from a debtor of the depositor to a transferee within the meaning of Section 60a of the Bankruptcy Act, 11 U.S.C. §96(a).

2. Whether deposits to a general unrestricted checking account made by a corporate depositor within four months of bankruptcy are transfers under Section 60a of the Act,

* References to the annexed appendices will be designated "App."

11 U.S.C. §96(a), where there is no showing of fraud or collusion between the depositor and the depository bank aimed at creating a preferential transfer of the depositor's property.

3. Whether a trustee in bankruptcy opposing a motion for summary judgment may rest upon the mere allegations of his pleading, without setting forth specific facts showing that there is a genuine issue for trial.

Statutes and Rules Involved

Section 60a(1) of the Bankruptcy Act, 11 U.S.C. §96(a)(1):

"§60. *Preferred Creditors.*

a. (1) A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this Act, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class."

Section 60b of the Bankruptcy Act, 11 U.S.C. §96(b):

"b. Any such preference may be avoided by the trustee if the creditor receiving it or to be benefited thereby or his agent acting with reference thereto has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent. Where the preference is voidable, the trustee may recover the property or, if it has been converted, its value from any person who has received or converted such property,

except a bona-fide purchaser from or lienor of the debtor's transferee for a present fair equivalent value...."

Section 68a of the Bankruptcy Act, 11 U.S.C. §108(a):

"*§68. Set-Offs and Counterclaims.*

a. In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid."

Rule 56(e) of the Federal Rules of Civil Procedure:

"*(e) Form of Affidavits; Further Testimony; Defense Required.*

Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein. Sworn or certified copies of all papers or parts thereof referred to in an affidavit shall be attached thereto or served therewith. The court may permit affidavits to be supplemented or opposed by depositions, answers to interrogatories, or further affidavits. When a motion for summary judgment is made and supported as provided in this rule, an adverse party may not rest upon the mere allegations or denials of his pleading, but his response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. If he does not so respond, summary judgment, if appropriate, shall be entered against him."

Statement of the Case*

On or about January 16, 1969, in consideration of a loan from the Bank in the amount of $125,000, Oakland Foundry of Belleville, Illinois ("Oakland" or the "bankrupt") executed a promissory note in favor of the Bank for the sum of $125,000. The promissory note was later made payable on demand on June 18, 1977. Oakland's indebtedness to the Bank was guaranteed by its president, Herman W. Brede ("Brede"), his wife, Bette D. Brede, and by Electronics Cabinets, Inc., a corporation whose stock was owned by Brede.

At the time of the Bank loan to Oakland, Oakland opened a general checking account with the Bank (the "Glen Head Account"), and there were no restrictions on Oakland's right to make withdrawals. Oakland also maintained another account at the St. Clair National Bank of Belleville, Illinois (the "St. Clair Account").

From the inception of the loan, Oakland deposited its funds into the Glen Head Account and the St. Clair Account. From January 6, 1970 until April 15, 1971, "at least 260 checks" were drawn on the Glen Head Account. Oakland made deposits to the Glen Head Account aggregating $47,738.56 during the month of April, 1971, $48,105.05 in May of 1971, and $12,075.21 in June of 1971.

On or about June 29, 1971, Brede, as Oakland's president, called Anthony D. Famighetti ("Famighetti"), then president of the Bank, and told him that Oakland was in

* The facts are distilled from the opinions of the lower courts, and those set forth herein are undisputed.

"financial trouble." As a result of this conversation, on June 30, 1971, the Bank set off the amount on deposit in the Glen Head Account, aggregating $108,783.91, against Oakland's original indebtedness of $125,000. Brede and Famighetti, without contradiction, later confirmed under oath their conversation on June 29, 1971, and that there had been no prior communications between Oakland, Brede and the Bank relating to Oakland's financial problems. No evidence to the contrary has ever been offered by the plaintiff-respondent.

On July 15, 1971, an involuntary petition in bankruptcy was filed against Oakland in the United States District Court for the Eastern District of Illinois. Oakland was subsequently adjudged bankrupt on August 18, 1971, and Donald Katz, the respondent (hereinafter referred to as the "Trustee"), was appointed trustee in bankruptcy for the Oakland estate on October 12, 1971.

On July 13, 1973 the Trustee filed a complaint in the United States District Court for the Eastern District of New York, alleging that the Bank received a preferential transfer from Oakland in the aggregate sum of $108,732.07, which was purportedly voidable under Section 60b of the Act. No other claim for relief was made, and the jurisdiction of the district court was invoked under Sections 23 and 60b of the Act. In essence, the Trustee claimed that Oakland's deposits made during the four-month period preceding bankruptcy "were not made or accepted in the regular course of [the Bank's] business or in good faith," and that the Bank's set-off on June 30, 1971 was thus improper.

The district court found that the Trustee's allegations were without foundation in fact because "there [was] nothing in the record by which the trustee could establish on a trial that these deposits were received by the Bank in anything other than its ordinary course of business." Accordingly, the district court granted the Bank's motion for summary judgment dismissing the complaint, holding that "the bank had a right of set-off and its exercise thereof did not constitute a voidable preference."

A divided panel of the Second Circuit, made up of one Circuit Judge and one District Judge sitting by designation, held "that the legal standard articulated by the district court was erroneous" and reversed the district court's judgment. According to the majority opinion, "[i]f a depositor fully intends to leave the deposits in the account, available for set-off, they constitute payments on account of an antecedent debt whether or not at the time the deposits are made the bank knows it." App. I, at 5, 10. As noted by the dissenting Circuit Judge, the majority thus held that "a unilateral decision by a depositor not to exercise his right to draw checks against his account transforms the bank, without its knowledge, from a debtor to a transferee." App. I, at 12.

The dissenting opinion also noted the "long run" effect of the majority's decision on all financially troubled businesses. Because the "businessman seeking credit is most likely to secure it at the bank where he is a depositor," and "because the right to set-off encourages [the bank] to continue credit when it might be induced otherwise to call its loans," the majority's opinion removes "[the] inducement for the bank to work along with the financially troubled entrepreneur." According to the dissent, Congress wanted

to encourage such cooperation from banks when it preserved the bank's right of set-off in the Chandler Act amendments to the Act in 1938, and such a right should not be judicially eliminated. App. I, at 16.

REASONS FOR GRANTING THE WRIT

I

The decision below conflicts with a prior decision of this Court.

The basic issue before the Second Circuit and the district court was whether the bankrupt made a transfer under §60a of the Act. On its motion for summary judgment in the district court, the Bank noted that the Trustee had failed to make out a *prima facie* case because he had failed to show, among other things, insolvency at all material times or that Oakland had made a transfer of its property. "For purposes of . . . [the Bank's] motion," the district court merely "assumed . . . Oakland was insolvent and that the bank had reasonable grounds to believe that Oakland was insolvent." App. II at 21.

A. Oakland made no transfer of its property within the meaning of Section 60 of the Act.

The holding of the court below that Oakland's deposits in the Bank were "transfers" under Section 60 of the Act directly conflicts with this Court's often-cited holding in *New York County Nat'l Bank* v. *Massey,* 192 U.S. 138 (1904). In that case, this Court held that deposits in a bank are not "transfers" under Section 60 of the Act, where no

"fraud or collusion between the bankrupt and the bank" has been shown. 192 U.S. at 148. Thus, because "one of the elements of a preference enumerate in §60a is wanting [here], . . . a preference under the terms of §60 . . . has not been established." 3 Collier, Bankruptcy ¶60.02, at 758-60 (14th rev. ed. 1976).

In *Massey,* the plaintiff trustee in bankruptcy claimed that the defendant bank had received a preference when it set off its insolvent depositor's funds. Prior to the set-off, the bankrupts had asked the defendant bank to extend the maturity of its loan to them, saying that "they were unable to pay the notes then about to fall due." 192 U.S. at 142-43. The bankrupts were two individuals doing business as a partnership who were indebted to the defendant bank for the sum of $40,000, evidenced by four promissorry notes of $10,000 each. Although their business was known as "Stege & Brother," the business was apparently primarily liable on the notes to the defendant bank. Under traditional principles of partnership law, the individuals would be liable to the bank if the business was unable to repay the loans. *See* MacLachlan, Bankruptcy §356, at 425 (1956) ("Since under the entity theory the partner is still liable upon the firm debts, his position becomes like that of a surety."). It was undisputed that the bankrupts were insolvent when they deposited more than $6,000 in their account at the bank within four days of bankruptcy. After the bankruptcy adjudication, the bank claimed the full amount of its debt less the amount on deposit, which it had applied as a set-off against the outstanding indebtedness. The trustee in bankruptcy thereafter moved in the bankruptcy court for an order disallowing the bank's claim unless it surrendered

the amount of the deposits credited by the bank against the outstanding loans of the bankrupts. The Second Circuit reversed the order of the district court allowing the bank's claim, and held that the deposits were transfers, enabling the bank to obtain a greater percentage of its debt than creditors of the same class, and that allowance of the bank's claim should be refused unless the preference was surrendered. 192 U.S. at 144.

This Court reversed the Second Circuit's holding that the deposits were transfers, but accepted the findings that "the deposits were made in the usual course of business," and that "at the time they were made [the bankrupts] were insolvent," reasoning as follows:

> "It is true that the findings of fact in this case establish that at the time these deposits were made the assets of the depositors were considerably less than their liabilities, and that they were insolvent, but there is nothing in the findings to show that the deposit created other than the ordinary relation between the bank and its depositor."

192 U.S. at 145. The Court went on to explain why a deposit of money to one's credit in a bank does not diminish the depositor's estate:

> "[A] deposit of money to one's credit in a bank does not operate to diminish the estate of the depositor, for when he parts with the money he creates at the same time, on the part of the bank, an obligation to pay the amount of the deposit as soon as the depositor may see fit to draw a check against it. It is not a transfer of property as a payment, pledge, mortgage, gift or security. It is true that it creates a debt, which, if the creditor may set it off under §68, amounts

> to permitting a creditor of that class to obtain more from the bankrupt's estate than creditors who are not in the same situation, and do not hold any debts of the bankrupt subject to set-off. But this does not, in our opinion, operate to enlarge the scope of the statute defining preferences so as to prevent set-off in cases coming within the terms of §68a. If this argument were to prevail, it would in cases of insolvency defeat the right of set-off recognized and enforced in the law, as every creditor of the bankrupt holding a claim against the estate subject to reduction to the full amount of a debt due the bankrupt receives a preference in the fact that, to the extent of the set-off, he is paid in full."
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> ". . . It is true, as we have seen, that in a sense the bank is permitted to obtain a greater percentage of its claim against the bankrupt than other creditors of the same class, but this indirect result is not brought about by the transfer of property within the meaning of the law. *There is nothing in the findings to show fraud or collusion between the bankrupt and the bank with a view to create a preferential transfer of the bankrupt's property to the bank, and in the absence of such showing we cannot regard the deposit as having other effect than to create a debt to the bankrupt, and not a diminution of his estate.*"

192 U.S. at 147-48. [Emphasis added.] This Court's reasoning in *Massey, supra,* demonstrates that the Bank's obtaining a greater percentage on its claim than other creditors does not make the Bank's set-off voidable. Moreover, as proof that there was no transfer of the funds deposited in the Glen Head Account, any judgment creditor of Oakland could have enforced its judgment against the Glen

Head Account prior to the set-off on June 30, 1971. New York Civil Practice Law and Rules §5232(a).* Under this Court's analysis in *Massey*, therefore, the deposits from Oakland could not be deemed a transfer, as would a "payment, pledge, mortgage, gift or security."

As stated in *Massey*, for there to be a transfer, there must be "fraud or collusion between the bankrupt and the bank with a view to creat[ing] a preferential transfer of the bankrupt's property to the bank." Nevertheless, the Second Circuit disregarded the "fraud or collusion" requirement by holding that the bankrupt's subjective intention to transfer, without more, is sufficient.** As noted by the dissent, the Second Circuit's majority opinion conflicted with the holding in *Massey, supra*, that there be some participation or understanding on the part of the bank before an ordinary deposit can be considered a transfer. App. I, 15.

The district court properly summarized the record here as follows:

> "There is nothing to show that the bank engaged in any collusion with Brede or Oakland, that it in any way isolated or liened the funds in Oakland's checking

* The relevant portion of which reads as follows:

> "The person served with the execution [of the judgment creditor] shall forthwith transfer all such property . . . to the sheriff. . . . Until such transfer or payment is made, . . . the garnishee [i.e., the bank] is forbidden to make or suffer any . . . transfer of, or any interference with, any such property. . . ."

** The word "collusion" has been defined to mean "an agreement between two or more persons to defraud a person of his rights by the forms of law, or to obtain an object forbidden by law." Black's Law Dictionary, at 331 (1968 rev. ed.).

> account, or treated the transactions in any way different from any other general checking account. . . .
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> "Such action by the depositor alone is not enough to constitute a voidable preference. The test is not whether the deposits were made in the depositor's regular course of business, but instead, whether they were accepted by the bank in its regular course of business. Viewed in that light, there is nothing in the record by which the trustee could establish on a trial that these deposits were received by the bank in anything other than its ordinary course of business. The funds were kept available in the checking account, ready to be withdrawn anytime up until the right of set-off was exercised."

App. II at 24-25; 424 F. Supp. at 1177-78. The Trustee has never offered any evidence to show that the Bank received Oakland's deposits in other than the regular course of its business. Without pointing to any factual basis, the Second Circuit inexplicably accepted the Trustee's bald allegation that the Bank accepted Oakland's deposits outside of the ordinary course of its business.

There is also nothing in the record which even tends to show collusion between Oakland and the Bank for the purpose of making a preferential transfer of Oakland's property or for any other purpose. Indeed, it is undisputed that a debtor-creditor relationship existed between the Bank and Oakland, enabling Oakland to withdraw funds from the Glen Head Account at will. *See* App. II, at 19. ("The Glen Head account was a general account, and there were no restrictions on Oakland's right to make withdrawals."). In short, the Second Circuit disregarded this

Court's holding in *Massey*, and held that a wholly innocent bank can be held liable in a voidable preference action, a result which Congress never intended.

B. The commentators confirm the vitality of this Court's rule in *Massey*.

Set-off in bankruptcy and reorganization cases is still of vital concern to the business community, as noted by the commentators:

> "The Bankruptcy Act is, in a sense, a part of every business and commercial contract and relationship and there is general pragmatic recognition of its influence in the area of setoffs as is evidenced by the widespread requirement of commercial banks for the maintenance of compensating balances by business borrowers."

Morton, "Creditor Setoffs in Business Reorganization and Relief Cases Under the Bankruptcy Act," 50 Am. Bankr. L.J. 373, 387 (1976); *see also* Justman, "Comments on the Bank's Right of Setoff Under the Proposed Bankruptcy Act of 1973," 31 Bus. Law. 1607 (1976).

This Court's decision in *Massey, supra,* is still recognized as the "leading case on the subject" of the bank's right of set-off. Hanna & MacLachlan, Creditors' Rights and Corporate Reorganization, at 922 (5th ed. 1957); Riesenfeld, Creditors' Remedies and Debtors' Protection, at 667 (2d ed. 1975). Perhaps the most concise statement of the applicable law is contained in the leading bankruptcy treatise:

> "Here we are concerned with the right of a creditor bank to offset against its claim deposits made by an insolvent depositor within four months of bankruptcy. Within certain limitations, hereinafter elaborated, such a transaction has been held not to create a voidable preference within the meaning of §60, even though the result is that the bank fares better than other creditors of the bankrupt not similarly situated. The general rule may first be stated that where an insolvent depositor makes general deposits within four months of his bankruptcy, *which deposits are accepted in good faith and in the regular course of business,* the bank has a right to set off such deposits against an obligation owing to it by the depositor. Obviously, where the bank has no knowledge or imputation of knowledge, or 'reasonable cause to believe,' that the depositor is insolvent, such routine deposits are clearly available as set-offs. But even though the depositor was insolvent and knowledge of this fact could be charged against the bank at the time when the deposit was made, the bank is still entitled to apply the deposit on its claim, *so long as it was accepted in good faith, in the ordinary course of business.* It is only where affairs have reached such a point that the bank accepts the deposit for the purpose of payment, or of giving itself a subsequent advantage over other creditors through its right of set-off, or for some other special purpose, that the deposit and the subsequent application of it amounts to a recoverable preference."

4 Collier, Bankruptcy ¶68.16, at 915-920.1 (14th rev. ed. 1975). [emphasis added.]

Thus, the commentators interpreting this Court's decision in *Massey, supra,* emphasize that a depository bank must be culpable in order for it to be held liable as the recipient of a preferential transfer. Moreover, only by focusing on whether the Bank accepted the deposits in good faith in the regular course of its business can a court prop-

erly apply the "fraud or collusion" requirement contained in *Massey*. By disregarding the Bank's innocence and good faith conduct here, the Second Circuit ignored this Court's reasoning in *Massey*. *See also* MacLachlan, Bankruptcy §292, at 343 (1956) ("True, the cases do not permit the Bank to apply and retain deposits for a special purpose or deposits made pursuant to an agreement between the Bank and the depositor that the account be built up while other creditors are kept waiting, but the mere fact that such a result was achieved is considered insufficient evidence of an agreement to that effect. . . .").

II

The decision below conflicts with the decisions of other courts of appeals.

The Second Circuit's opinion not only ignores the "fraud or collusion" requirement established in *Massey, supra,* but also conflicts with the decisions of other* courts of appeals that have followed *Massey*. The Fourth Circuit's decision in *Citizen's Nat'l Bank* v. *Lineberger,* 45 F.2d 522 (4th Cir. 1930), is most often cited by courts to explain the applicable law.

In *Lineberger,* the plaintiff-trustee in bankruptcy asserted that the defendant bank's set-off after bankruptcy constituted a voidable preference, primarily because the

* Indeed, the Second Circuit overruled, in effect, its own prior decisions upholding an innocent bank's right of set-off. *See, e.g., Matters* v. *Manufacturers Trust Co.,* 54 F.2d 1010, 1013 (2d Cir. 1931) (". . . [I]f there is to be a recovery, the bank must understand that the account is being built up so as to be available at the proper time for seizure.").

bank knew of the depositor's insolvency when deposits were made in the depositor's checking account. Holding that the bank was still entitled to set off the moneys on deposit against the depositor's indebtedness, and relying on this Court's decision in *Massey, supra,* the court found that a "deposit in a bank is not a sale or parting with property, or its possession, as a payment, pledge, mortgage, gift or security." 45 F.2d at 527-28. More significant was the court's finding of no "fraud or collusion" between the depositor and the bank, even though (1) the bankrupt's officers and stockholders had personally guaranteed the bankrupt's obligation to the bank; (2) the bank's president was the brother-in-law of one of the guarantors and was told of the bankrupt's financial condition almost 3 weeks before bankruptcy; and (3) deposits were made in the bankrupt's account during this three-week period. 45 F.2d at 523-24.

> "*There is no evidence whatever of any agreement or understanding between the officers of the bankrupt company and the bank that deposits were to be piled up for the payment or security of the bank. There is no evidence that they were not to be withdrawn at any time that the company saw fit to check against them.* Its checks against them, as a matter of fact, were paid; and there is nothing upon which to base even an inference that a check withdrawing the entire deposit would not have been honored up until the very day of the filing of the petition in bankruptcy. . . .
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> "It is true that the bank had notice that the company was in financial difficulties and that it was making an offer of compromise to its creditors, but we do not think that this affected the nature of the deposits or precluded the bank from applying the deposit balance against the notes which it held. We have already seen

that the bank's knowledge of the insolvency of the depositor does not have this effect, and there is no reason in law or in logic why the added element of knowledge of the offer of compromise should do so; *for such knowledge does not show collusion between the bank and the company, nor does it rob the deposit of the distinguishing characteristic of being subject to the control of the depositor and withdrawable at his will.*"

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". . . The deposit of money in the bank in ordinary course of business was no violation of the agreement to preserve and protect the assets in the interests of all creditors, nor, as we have seen, was it a preferential transfer. *If there had been collusion between the officers of the company and the bank, or other circumstance showing that the deposits were not made in ordinary course of business, the bank would have been precluded from asserting a set-off with respect to the deposits* . . . .

". . . Even though a corporation be insolvent, it does not lose the right of doing business in the ordinary way with a bank, *nor does a bank in doing business with it relinquish any of its ordinary rights or remedies.* If there were showing that the deposits in question were made fraudulently or collusively, as a cloak for payments to the bank or as a means of giving it security, the trustee could avoid them under the Bankruptcy Act, without resort to the trust fund doctrine, *if the bank were shown to have been a party to the fraud or collusion, or to have accepted the deposits as a means of obtaining payment or security.*"

45 F.2d at 530-31. [Emphasis added.] The court emphasized that the defendant bank must have some degree of culpability for it to lose its right of set-off; there must be an "agreement or understanding between the officers of the bankrupt company and the bank that deposits were to be piled up for the payment or security of the bank."

45 F.2d at 530. *See* Morris, "Bankruptcy Law Reform: Preferences, Secret Liens and Floating Liens", 54 Minn. L. Rev. 730, 738-740 (1970). ("The present test [of avoidability] is not stated in terms of culpability, but it does include culpable creditors—those who are privy to the debtor's plan to supersede the bankruptcy scheme of distribution.").

The Eighth Circuit also requires a showing of "fraud or collusion" in order to preclude a bank from exercising its right of set-off. In *Farmers Bank of Clinton, Missouri* v. *Julian*, 383 F.2d 314 (8th Cir.), *cert. denied*, 389 U.S. 1021 (1967), the court of appeals reversed the bankruptcy court's finding of a voidable preference when a bank set off the funds on deposit in the bankrupt's general checking account. Although the bankruptcy judge found that substantial deposits were made in the bankrupt's account immediately preceding bankruptcy, the defendant bank was permitted to keep the moneys set off because of the absence of any collusion between the bankrupt and the bank.

"The Bank did not avail itself of the right of setoff until after an official of the Bank on the morning of June 30 had gone to [the bankrupt's] place of business to discuss [with the bankrupt] and an agent of [a third party] the making of a long-term capital loan. . . . It was not until the officer of the Bank found out that [the third party] would not make the long-term loan that the Bank proceeded to set off the account. It was at that point that the officer of the Bank returned to the Bank and made an immediate setoff.

"The Bank on that same day had already honored a number of checks totaling some $1,400. This evidence clearly indicates that there was no collusive build-up of the bank account and that the Bank only

decided to make the setoff on the day the setoff was actually executed. The refusal of [the third party] to proceed with the long-term capital loan triggered the Bank's decision to avail itself of the setoff right.

"... [T]here is absolutely no evidence of any collusive or pre-arranged plan of action between [the bankrupt] and the bank to build up this account."

383 F.2d at 325. Although the Second Circuit purported to distinguish the *Julian* case on the ground that the bank accounts "were long-standing, active accounts" (App. I, at 11), it is submitted that the absence there of collusion between the bankrupt and the bank was controlling. Moreover, the Second Circuit's statement that there "was *no* evidence that the funds were . . . deposited by the bankrupt other than in the regular course of [its] business" (App. I, at 10-11) is contradicted by the facts in the *Julian* case.

"The Referee's reasons were that on June 27, 1959, the bankrupt's bank balance was $34.84; on June 29, 1959 it was $10,581.15 plus an additional deposit on that same day of $762.15; and on June 30, 1959, a deposit of $480 was made. These deposits built up the account to $11,197.14, which build-up the Referee found to be under 'pre-arrangement'."

383 F.2d at 324. Thus, there *was* evidence of an intentional build-up by the depositor prior to bankruptcy in *Julian*. Because there was no evidence "of any collusive or pre-arranged plan of action between" the bankrupt and the defendant bank, however, the bank's set-off was upheld.

Similarly, the First Circuit has emphasized that the defendant bank must be culpable before it can be denied its right of set-off. In *Plymouth County Trust Co.* v.

MacDonald, 60 F.2d 94 (1st Cir. 1932), the indebtedness of the bankrupt was evidenced by demand notes. In June of 1929, a meeting of the bankrupt's shareholders was held, and attended by the president of the defendant bank. At that time, the shareholders voted to allow the bankrupt to continue in business for three more months, and no objection was made by the president of the bank. The bankrupt continued to make deposits with the bank after the shareholders' meeting. According to the court,

"it does not follow because a bank knows that a depositor is insolvent that the application of funds on deposit in a checking account to a claim against a depositor constitutes a preference. A bank is permitted to apply funds on deposit, *and received in the usual course of business*, to a claim against the depositor under section 68 of the act (11 U.S.C.A. §108) relating to set-offs." [Citations including this Court's decision in *Massey, supra*, omitted.]

* * *

"The deposits prior to July 10 were, of course, not made by the bankrupt with any idea of giving a preference to the bank, *nor were they received*, as the referee found, *with any intent on the part of the bank to apply them to its claim*, but subject generally to the corporation checks. The bank continued to receive deposits and honor checks up to July 12th. It was not until the receipt of the check for $15,100.78 on the morning of the 12th that the officers of the bank evidently saw an opportunity to anticipate a loss they foresaw it would inevitably suffer, and applied all collected funds to the note. Even though the bank officials well knew that their proposed action would force an assignment or bankruptcy, the bank had its right to set-off, even prior to bankruptcy, *of any sums received on deposit in the usual course of business.* That a creditor

with a right of set-off thereby secures an advantage to the extent of its claim against the bankrupt is not the test. Was it done, knowing that the debtor was insolvent and with the intent to secure a preference within the meaning of the Bankruptcy Act?

> "The deposits making up the $4,027.29 applied on July 12th [which had been deposited on July 10], were made with the understanding on the part of the depositor that they were subject to be withdrawn on its checks for a period of at least three months, and *were received by the bank with the same understanding.* The record discloses *no intent on the part of the bank* on receiving deposits prior to July 10th to apply them on its note, but rather an *intent to hold them subject to check,* and they were, of course, deposited by the bankrupt, to be drawn against as needed in conducting its business."

60 F.2d at 96-97. [emphasis added.] Thus, the First Circuit also required some evidence of "fraud or collusion" between the bankrupt and the defendant bank in order to find a "transfer" so as to deprive the bank of its right of set-off. The Second Circuit, however, would hold the Bank liable here, regardless of its intent or its innocence. App. I, at 12. Because there is now a conflict in the circuits as to the proper construction of an important and often-used* term in the Act—"transfer"—this Court should grant a writ of certiorari in order to resolve this issue of importance in bankruptcy litigation.

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* Virtually all of the avoiding powers of a trustee in bankruptcy are based on the definition of "transfer". *See, e.g.,* Sections 60a, 67d, 70c and 70e of the Act; 3 Collier, Bankruptcy ¶60.01, at 743-55 (14th rev. ed. 1975).

III

Congress has consistently refused to limit a bank's right of set-off in the manner prescribed by the court below.

The dissent in the Second Circuit noted that "Congress has refused to eliminate" a bank's right of set-off in the case of a financially distressed debtor. App. I, at 17. By eliminating, in effect, an innocent bank's right of set-off here, the majority in the Second Circuit has substituted a new and debatable rule which has been rejected by Congress.

In 1936, the National Bankruptcy Conference included in the original draft of the Chandler amendment to the Bankruptcy Act a new provision declaring deposits in a creditor bank to be transfers and subjecting them to the same tests of a voidable preference as other transfers under Section 60 of the Act. The history of this proposed legislation has been succinctly described as follows:

> "[The proposed legislation] was designed to meet the case where instead of making a transfer of property to a creditor, the debtor loaned him money. It was probably broad enough to include the set-off of deposits by banks which [the proposed legislation] specifically covered. Professor McLaughlin of Harvard University was largely responsible for [the proposed legislation] and had ardently championed the theory underlying it. He did not propose to abolish the banks' right of set-off, but he felt that after the bank had learned that a depositor to whom it had loaned money was insolvent, it should not be able to profit from the fact that additional deposits were made by the depositor. Banks

and banking associations, on the other hand, felt that there was a difference between the extension of bank credit and the extension of ordinary commercial credit, and that unless a bank was able with some degree of safety to carry a depositor after it had learned of his financial difficulties, many customer depositors would be driven into bankruptcy who might otherwise extricate themselves from their financial difficulties."

• • •

"Nevertheless, Professor McLaughlin did not prevail, and in subsequent forms of the Chandler Act, H.R. 6439 (April 15, 1937) and H.R. 8046 (July 28, 1937, subsequently enacted) [the proposed legislation was] omitted from the provisions of §68. The legislators evidently thought along the same lines as Mr. Justice Lamar in *Studley* v. *Boylston National Bank,* [229 U.S. 523, 529 (1913)] when he stated that an effort to enlarge the scope of the statute to deny the banks' right of set-off 'would in many cases make banks hesitate to honor checks given to third persons, would precipitate bankruptcy and so interfere with the course of business as to produce evils of serious and far-reaching consequence'."

4 Collier, Bankruptcy ¶68.01[3], at 845-48 (14th rev. ed. 1975); *see also* 2 Glenn, Fraudulent Conveyances and Preferences §407 (rev. ed. 1940); MacLachlan, Bankruptcy §292, at 343 (1956) ("It is not surprising that banker opposition caused the amendment to be stricken from the Chandler Act. Indeed, a plausible case can be made out for granting banks a straight statutory priority in bankruptcy. Certainly a failing depositor can procure a longer extension of bank credit if the bank is going to be in a favorable position as against other creditors, and sometimes the extension saves a situation and prevents a failure.").

Current proposals to revise the Bankruptcy Act still preserve a bank's right of set-off for valid reasons. According to the House Committee Report accompanying one of the most recently proposed revisions of the Bankruptcy Act,

"[s]etoff most often arises in the bank context. Although the governing principles may be same for the bank context as for mutual debts and credits among merchants, the fact patterns are most often different. Banks are generally more familiar with the financial affairs of their debtors than are arms-length merchants. Especially when a debtor is sinking into financial difficulty, the bank will take an increased interest in the operations of the debtor. In order to encourage a bank to carry a debtor through difficult times without the threat of losing a setoff right after bankruptcy, it may be desirable to permit . . . bank setoff in any event."

• • •

"Different treatment of setoff that occurs prepetition and postpetition may generate problems for insolvent debtor. If the restrictions placed on postpetition setoff are greater than those placed in prepetition setoff, there is an incentive for creditors with a right of setoff, especially banks, to offset during a period of financial difficulty of the debtor, rather than continuing to carry the debtor in hopes that matters will improve. . . ."

• • •

". . . The result [of the proposed legislation] is to encourage business workouts, by discouraging precipitious [sic] action."

H.R. Rep. No. 595, 95th Cong., 1st Sess. 184-86 (1977); H.R. 8200, 95th Cong., 1st Sess. §101 (proposed 11 U.S.C. §553) (1977); S. 2266, 95th Cong., 1st Sess. §101 (proposed 11 U.S.C. §553) (1977). Because courts are supposed to con-

strue what Congress has said, and not substitute their own views of what the law should be, this Court should grant the writ of certiorari to review the Second Circuit's decision.

IV

The decision below conflicted with the applicable standards for summary judgment articulated by this Court and other circuits.

The Second Circuit held that the "trustee's allegations," in and of themselves, "raised a sufficient question of fact to make summary judgment inappropriate . . .," App. I, at 7, n.6. This holding contradicts not only the plain language of Fed.R.Civ. P. 56(e), but also the established standard of this Court and other circuits.

Fed.R.Civ.P. 56(e) provides in pertinent part that a party responding to a motion for summary judgment "*must set forth specific facts* showing there is a genuine *issue for trial.*" [emphasis added.] He cannot merely rest on the "allegations . . . of his pleading." In effect, the Second Circuit has read this rule out of plenary suits brought by a trustee in bankruptcy.

A. This Court's Criteria for Opposing a Motion for Summary Judgment

In *First National Bank* v. *Cities Service Co.*, 391 U.S. 253 (1968), this Court held "that a party cannot rest [merely] on allegations . . . in opposition to a properly supported summary judgment motion made against him." 391 U.S. at 290. There, the plaintiff charged that the de-

fendant was part of an international oil cartel which had effectively boycotted plaintiff's oil. This Court affirmed the lower court's decision granting defendant's motion for summary judgment. According to the Court, the pleadings showed no motive on the defendant's part to engage in an illegal conspiracy, nor did the plaintiff come forward with evidence to rebut the defendant's documented explanation that the unattractiveness of plaintiff's offer deterred defendant's purchase.

> "To the extent that petitioner's burden-of-proof argument can be interpreted to suggest that Rule 56(e) should, in effect be read out of antitrust cases and permit plaintiffs to get to a jury on the basis of the allegations in their complaints, coupled with the hope that something can be developed at trial in the way of evidence to support those allegations, we decline to accept it. While we recognize the importance of preserving litigants' rights to a trial we are not prepared to extend those rights to the point of requiring that anyone who files an antitrust complaint setting forth a valid cause of action be entitled to a full-dress trial notwithstanding the absence of any significant probative evidence tending to support the complaint."

391 U.S. at 290.

The Court's reasoning is applicable here. The Second Circuit's holding that "summary judgment [is] inappropriate," App. I at 7, n.6, was based solely on

> "[t]he trustee's *allegations* about [the Bank's president's] continuous knowledge of the course of Oakland's accelerating financial difficulties and his communications with Brede. . . ." [emphasis added.]

App. I, at 7, n.6. According to the court below,

> "[i]*f* [*the Trustee's*] *allegations* [*were*] *proven,* [it] would satisfy the requirement of the district court's legal test that there be dealings outside the regular

course of the bank's business or complicity between Brede and the bank. *These allegations raised a sufficient question of fact to make summary judgment inappropriate. . . .*"

App. I, 7, at, n.6. [Emphasis added.] Although the Second Circuit focused on the Trustee's allegations, it significantly failed, as did the Trustee, to show any evidentiary support for such allegations. Thus, to support his allegation of the Bank's "continuous knowledge of . . . Oakland's accelerating financial difficulties and [its] communications with Brede," the Trustee relied exclusively on "informal discussions" with third persons described in his own self-serving answers to the Bank's interrogatories and his own deposition taken by the Bank. *See* Joint Appendix filed in Second Circuit ("Joint App."), at 15-16.

Although Fed. R. Civ. P. 56(e) requires "opposing affidavits [to] be made on personal knowledge, [and] set forth . . . facts . . . admissible in evidence," the Trustee submitted no such evidence in opposition to the Bank's motion, and the Second Circuit cited none. Thus, the Second Circuit has read Rule 56(e) out of bankruptcy cases so as to permit the Trustee to get to a jury on the basis of his unsupported allegations. Significantly, the Trustee offered no affidavit or deposition testimony from either of the persons on whom his hearsay evidence is based. His examination of Brede in the bankruptcy court, however, on October 12, 1971 (Joint App., at 190), contradicts the unsupported allegations on which the Second Circuit relied. Thus, unless the Court is now willing to make an exception to Rule 56(e) for trustees in bankruptcy, a trustee can obtain a jury trial in the Second Circuit, despite the absence of any evidence to support the allegations of his complaint.

B. The Decisions of Other Circuits

The Second Circuit's holding that a party's allegations are alone sufficient to overcome a motion for summary judgment would emasculate Fed.R.Civ.P. 56(e). For that reason, other circuits have required trustees in bankruptcy to support their allegations with evidence in order to withstand a motion for summary judgment.

In *King* v. *National Industries, Inc.*, 512 F.2d 29 (6th Cir. 1975), which had a fact pattern similar to that presented here, the Sixth Circuit expressly refused to let a trustee oppose a motion for summary judgment by merely resting on his allegations, the truth of which would assertedly be established at trial. There, the trustee of a Chapter X debtor commenced an action to set aside a transaction on the grounds that it was a fraudulent conveyance under Sections 67d and 70e of the Act. The court focused on whether there had been a "transfer" of the debetor's "property" within the meaning of Section 1(30) of the Act, without which, the court held, there could be no fraudulent conveyance. 512 F.2d at 32. The defendant moved for summary judgment, relying on an affidavit which showed that the debtor never had a beneficial interest in the subject property. In response, the plaintiff-trustee submitted his attorney's affidavit which "stated that while plaintiff was unable at that time to offer countervailing affidavits from persons having personal knowledge of the circumstances . . . , he could point to evidence which would be available to him at trial to support his position." 512 F.2d at 31.* In

* The affidavit submitted here by the Trustee's attorney, the only affidavit submitted by the Trustee, does not even go this far. *See* Joint App., at 31-33.

affirming the district court's decision granting the defendant's motion for summary judgment, the Sixth Circuit explained as follows:

> "Summary judgment in this case for [the defendant] was proper since no genuine issue of material fact was raised by plaintiff. The issue upon which the case turns is whether plaintiff had 'property' which could be transferred under the 1970 agreement in violation of the Bankruptcy Act. The issue has been extensively briefed and was an appropriate one for decision by the district judge as a matter of law. The affidavit of plaintiff's attorney Palmer was insufficient to rebut the affidavit of Solomon accompanying defendant's motion for summary judgment. *Plaintiff may not raise an issue of fact by merely referring to the proposed testimony of possible witnesses.* Palmer [plaintiff's attorney] in his affidavit indicates no personal knowledge of the facts relevant to the case. *An affidavit stating what the attorney believes or intends to prove at trial is insufficient to comply with the burden placed on a party opposing a motion for summary judgment under Rule 56. Automatic Radio Mfg. Co.* v. *Hazeltine Research Inc.*, 339 U.S. 827, 831, 70 S.Ct. 894, 94 L. Ed. 1312 (1950), *Mercantile National Bank at Dallas* v. *Franklin Life Insurance Co.*, 248 F.2d 57, 59 (5th Cir. 1957)."

512 F.2d at 34. [Emphasis added.] The Sixth Circuit's reasoning is equally applicable here, and underscores the conflict between the Second and Sixth Circuits. Here, the Trustee's attorney submitted only his affidavit in opposition to the Bank's motion for summary judgment, without more. That affidavit has virtually no probative value. *Mercantile Nat'l Bank at Dallas* v. *Franklin Life Ins. Co.*, 248 F.2d 57, 59 (7th Cir. 1957) ("Based upon these facts, the court below granted the beneficiary's motion for summary judg-

ment. . . . There were no affidavits on file, except that the attorneys for the rival claimants appended their own affidavits to some of the pleadings. In no instance did such affidavits show that the facts were based upon the affiants' knowledge; or that they otherwise complied witht the requirements of Rule 56(e) F.R. Civ. P., 28 U.S.C.A. In fact it is obvious that the attorneys did not have any personal knowledge of the facts and that they were not competent to testify to them. Such affidavits have no probative value on a motion for summary judgment. 6 Moore's Federal Practice, 2d Ed., pp. 2325 and 2330."); *Minnesota Mining & Mfg. Co* .v. *United States Rubber Co.*, 279 F.2d 409, 416 (4th Cir. 1960) (". . . the affidavit of counsel based upon hearsay and not upon personal knowledge does not satisfy the requirement of [Fed. R. Civ. P. 56(e)], Chapman v. U.S., 8th Cir., 139 F.2d 327."); *Antonio* v. *Barnes*, 464 F. 2d 584, 585 (4th Cir. 1972) ("Our examination of the affidavits persuades us that the challenge of their sufficiency is valid. While each affidavit states that the affiant is 'competent to make this affidavit,' there is no showing whatever that the statements therein were made on personal knowledge as required by the Rule [56]. From the face of the affidavits, they might well be based on mere hearsay or, at best, reflect only a summary of the general routine prescribed for the institution. The absence of an affirmative showing of personal knowledge of specific facts vitiates the sufficiency of the affidavits. . . ."). Moreover, there is nothing in the record here which even tends to show fraud or collusion between Oakland and the Bank, or that the Bank accepted Oakland's deposits other than in the ordinary course of its business. To the contrary, two persons with personal knowledge of the facts have contradicted the Trustee's bare assertions. Joint App., at 136-37, 190.

The Fifth Circuit also requires probative evidence to withstand a motion for summary judgment. In *Solomon* v. *Houston Corrugated Box Co., Inc.*, 526 F.2d 389 (5th Cir. 1976), the Fifth Circuit explained the circumstances under which a "genuine" issue of fact remained for trial. There, the plaintiff commenced an antitrust action alleging that the defendant, his major supplier, had agreed to sell its product solely to plaintiff's chief competitor, the co-defendant, in order to insure that the competitor would monopolize the trade. The defendants moved for summary judgment, introducing sworn, reasonable and believable evidence concerning business dealings rebutting plaintiff's allegations. In affirming the granting of the defendants' motion, the Fifth Circuit reasoned as follows:

> "The mere allegation of the Sherman Act claim requirements of a contract, combination, or conspiracy for the purpose of restraining trade or interstate commerce and resulting damages are not sufficient to withstand a motion for summary judgment once they have been rebutted, *ALW, Inc.* v. *United Air Lines, Inc.*, 510 F.2d 52, 54-57 (9th Cir. 1975); see, e.g., *Kemp Pontiac-Cadillac, Inc.* v. *Hartford Automobile Dealers' Ass'n*, 380 F.Supp. 1382, 1389 (D.Conn. 1974) ('glib and conclusory allegations' of conspiracy are insufficient to raise genuine issues in face of specific denials in sworn depositions and affidavits by defendants); *Searer* v. *West Michigan Telecasters, Inc.*, 381 F.Supp. 634, 643 (W.D.Mich. 1974) (the policy of sparing use of summary procedures in antitrust cases 'is no warrant for every plaintiff who can draft an antitrust complaint, no matter how groundless or improbable its allegations, to force his claim to trial despite its deficient factual underpinnings'); *Murdock* v. *City of Jacksonville*, 361 F.Supp. 1083, 1086-87 (M.D.Fla. 1973) ('Even in an antitrust case a party cannot rest on the allega-

> tions contained in his complaint but must, in opposition to a motion for summary judgment, come forward with affidavits setting forth specific facts showing that there is a genuine issue of material fact for trial') (citations omitted).
>
> "We have recently had occasion to apply these principles in *Scranton Construction Co.* v. *Litton Industries Leasing Corp.*, 494 F.2d 778, 782 (5th Cir. 1974), *cert. denied*, 419 U.S. 1079, 95 S.Ct. 774, 42 L. Ed.2d 800 (1975), wherein we stated:
>
> > 'We have searched the record in vain for evidence supporting plaintiffs' allegations of a combination or conspiracy against them between Litton and anyone in the area of plaintiffs' claims. Proof of this is, of course, essential to plaintiffs' case under §1 of the Sherman Act and to its conspiracy claims under §2. Facing defendants' sworn challenge to the existence of such a conspiracy, it was up to plaintiffs to produce *significant probative evidence*—by affidavit or deposition—demonstrating that a *genuine* issue of fact existed as to this element of the complaint, if summary judgment was to be avoided. (citations omitted, emphasis added).'
>
> "Similarly, a review of the record in this case reveals a total lack of any significant probative evidence, by means of sworn affidavits or depositions, supportive of appellant's contention that genuine issues of material fact exist."

526 F.2d at 393-394 [emphasis in text].

In *Golden Oil Co., Inc.* v. *Exxon Co., U.S.A.*, 543 F.2d 548 (5th Cir. 1976), the Fifth Circuit reiterated its requirements for opposing summary judgment:

> "It is elementary that when the party moving for summary judgment supports his motion with sworn matter or admissions, the opponent bears a burden of present-

> ing affidavits or other proper matter sufficient to create a genuine dispute of fact. Pleadings will not suffice to defer the evil day, and the opposing party, facing such a situation, may not choose to wait until trial to develop claims or defenses relevant to the summary judgment motion."

543 F.2d at 548.

In this case, the Trustee could not produce more than vague, conclusory and unsupported allegations in opposition to the Bank's motion for summary judgment. The district court correctly found that he would have no more convincing evidence at trial. Indeed, the Trustee "conceded that if on the law relief required the bank's involvement in the build-up of the account, and if there was nothing in the papers before the court to create a question of fact as to the bank's participation, collusion or complicity in a plan by Brede to prefer the bank over the other creditors, then summary judgment would have to be granted to the defendant." App. II, at 25.

This case had been pending in the district court for more than three years before the hearing on the Bank's motion for summary judgment. During that time, the Trustee deposed Mr. Famighetti, the only officer of the Bank with personal knowledge of the facts. In addition, the Trustee examined a multitude of documents, and had more than three years to obtain whatever proof might be necessary to oppose the Bank's motion. He had ample opportunity, of which he availed himself, to examine the Bank's files and records to search for any documents relating to his assertions. Nevertheless, the Trustee submitted no evidence which would preclude the district court from grant-

ing the Bank's motion for summary judgment. As even the Second Circuit recognized prior to its decision here, a party opposing a motion for summary judgment, like the Trustee, must produce "significant probative evidence tending to support [his position]." *United States* v. *Pent-R-Books, Inc.*, 538 F.2d 519, 529 (2d Cir. 1976), *cert. denied*, 45 U.S. L.W. 3586 (March 1, 1977). If summary judgment is to remain vital in the Second Circuit, the Court must grant the writ of certiorari here to insure a uniform construction of the Federal Rules of Civil Procedure. *Northwestern Nat'l Ins. Co.* v. *Corley*, 503 F.2d 224, 230 (7th Cir. 1974) ("... [R]esort to summary judgment is a 'salutary procedural device,' . . . utilization of which in all appropriate cases should be encouraged rather than discouraged. . . ."); *Bland* v. *Norfolk & Southern R. R.*, 406 F.2d 863, 866 (4th Cir. 1969) ("While a day in court may be a constitutional necessity when there are disputed questions of fact, the function of a motion for summary judgment is to smoke out if there is any case, i.e., any genuine dispute as to any material fact, and, if there is no case, to conserve judicial time and energy by avoiding an unnecessary trial and by providing a speedy and efficient summary disposition.").

The Trustee failed to produce any evidence in the district court or in the Second Circuit to show that Oakland's deposits had not been received by the Bank in the ordinary course of its business, that such deposits had not been subject to withdrawal by Oakland, or that there was anything else unusual about such deposits. Nor was there any evidence to show that the Bank was in collusion with Oakland to build up the Glen Head Account so as to give the Bank preferred treatment over other creditors. Indeed,

the uncontradicted evidence shows that the Bank knew nothing of the bankrupt's plight until *after* the deposits in question were made, and only one day before the set-off. Accordingly, the district court properly granted the Bank's motion for summary judgment, in reliance on the criteria uniformly established by other circuits for determining motions for summary judgment.

Trustees in bankruptcy should be treated like other litigants, and should not be able to obtain a jury trial in the federal courts without probative evidence to support the allegations of their complaints. Because the Second Circuit has, in effect, given special status to these litigants in actions outside of the bankruptcy court, in contrast to the decisions of other circuits, this Court should review the decision below.

Conclusion

For these reasons, a writ of certiorari should issue to review the judgment and opinion of the Second Circuit.

Respectfully submitted,

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December 26, 1977

Appendices

Decision of the Second Circuit

TIMBERS, *Circuit Judge:*

Donald Katz, trustee in bankruptcy of the Oakland Foundry Company of Belleville, Illinois, Inc. (Oakland), sued The First National Bank of Glen Head (the Bank) in the Eastern District of New York to recover $108,732.07 which the trustee alleged constituted a voidable preference under §60 of the Bankruptcy Act, 11 U.S.C. §96 (1970).[1] The district court, George C. Pratt, *District Judge,* in an opinion filed October 19, 1976 granted the bank's motion for summary judgment and dismissed the trustee's complaint. From the judgment entered accordingly on October 22, 1976, the trustee has appealed.

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1. Throughout this opinion all statutory citations, unless otherwise stated, are to sections of the Bankruptcy Act, Title 11 of the United States Code, 1970 revision.

For example, here §60(a)(1), 11 U.S.C. §96(a)(1), provides:

> "A preference is a transfer, as defined in this title, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this title, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class."

The term "transfer" is defined in relevant part in §1(30), 11 U.S.C. §1(30), as follows:

> " 'Transfer' shall include the sale and every other and different mode, direct or indirect, of disposing of or parting with property or with an interest therein or with the possession thereof . . . , absolutely or conditionally, voluntarily or involuntarily, . . . as a conveyance, sale, assignment, payment, pledge, mortgage, lien, encumbrance, gift, security or otherwise."

§60(b), 11 U.S.C. §96(b), authorizes a trustee in bankruptcy to avoid a preference "if the creditor receiving it or to be benefited thereby . . . has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent."

The district court, in granting the bank's motion for summary judgment, assumed for purposes of the motion that the depositor was in fact insolvent at the time of the deposits and later set-offs, and that the bank had reasonable cause to believe it to be insolvent. Thus the narrow holding of the court below was that, since the bank had obtained the funds of the bankrupt by setting off money on deposit with the bank in the bankrupt's checking account, in conformity with §68(a), 11 U.S.C. §108(a),[2] there was no "transfer", and absent a transfer, no preference that could be avoided by the trustee.

We reverse and remand for trial in order to resolve certain issues of fact which we shall discuss more fully below. In reversing and remanding we are mindful of the traditional rule that in order to prove a voidable preference the trustee must show complicity or understanding on the part of the bank. This is in accordance with a long line of authority that a bank is entitled to set off deposits which were accepted in good faith and in the regular course of the bank's business. This rule in turn is premised on practical commercial considerations; it has survived the test of time; and, absent compelling reasons for doing so, it should not be disturbed. Within this framework, we hold that the district court misinterpreted the law and erroneously applied its

2. §68(a), 11 U.S.C. §108(a), provides:

"In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid."

The Supreme Court has approved a bank's right of set-off in *Studley* v. *Boylston National Bank*, 229 U.S. 523 (1913), and in *New York County Bank* v. *Massey*, 192 U.S. 138 (1904).

interpretation to the allegations of the complaint, thus foreclosing a jury's resolution of such critical issues of fact as whether, in view of the build-up and real nature of the Glen Head account, the bank acted in good faith in accepting the deposits or whether the account in fact was a general deposit account. To resolve these and other issues of fact we reverse and remand.

I.

The course of events which lead to the bank's exercise of its asserted right of set-off began on January 16, 1969 when the bank made a $125,000 loan to Oakland. This loan was obtained for Oakland by its president and chief executive officer, Herman Brede. Oakland was a wholly-owned subsidiary of Electronic Cabinets, Inc., all of whose stock was owned by Brede and his wife. Oakland's indebtedness to the bank was guaranteed personally by the Bredes, as required by the bank, and was secured by a pledge of all of the Bredes' stock in Electronic Cabinets, Inc. and all of their stock in another company wholly owned by the Bredes. When Oakland's indebtedness to the bank later was converted to a demand note in June 1970, the Bredes gave the bank additional security in the form of a second mortgage on their home. Pursuant to the bank's usual practice, Oakland opened a general checking account with the bank when the loan was first made.

Oakland had been having financial difficulties even before it obtained the loan from the bank. Its financial condition deteriorated until it virtually ceased doing business in March 1971. By June 1971 Oakland had either ceased making or reduced significantly office and factory payroll.

In the district court proceedings the trustee sought to show that Oakland's deposits in its Glen Head account constituted preferences by comparing the activity in that checking account with the activity in Oakland's checking accounts in an Illinois bank. The trustee also sought to prove that practically all of Oakland's banking activity was carried on through two accounts in the Illinois bank, while the Glen Head account remained substantially inactive from July 1970 until March 1971. During this period Oakland made only a few deposits in and withdrawals from the Glen Head account and the balance never rose above $5,800. Beginning April 20, 1971 this pattern changed markedly. From April 20 to June 30 Oakland built up the balance in its Glen Head account from $865.09 to over $100,000. During this period no withdrawals were made. The first reduction in the balance occurred on June 30 when the bank set off the sum of $108,783.91 against the $125,000 which Oakland owed on the loan.

The trustee also sought to prove that Anthony D. Famighetti, the bank's president and the officer primarily concerned with the Oakland loan, was aware of Oakland's worsening financial condition and that he was aware that the Glen Head account was being built up in anticipation of Oakland's impending bankruptcy, thus to be available for a set-off by the bank. On June 29, 1971 Brede called Famighetti to apprise him of Oakland's difficulties. Brede told Famighetti that he would try to work something out with Oakland's creditors. Famighetti immediately placed a freeze on Oakland's account. On June 30 the bank executed the set-off and applied it against the outstanding $125,000 loan. On July 15 an involuntary petition in bankruptcy was filed in the Eastern District of Illinois against Oakland which was adjudicated a bankrupt on August 18.

For purposes of the bank's motion for summary judgment the district court correctly accepted as undisputed the essential facts summarized above to the extent that they were asserted by the bank in support of its motion and admitted by the trustee in his answering papers. On the basis of the undisputed facts the court concluded that Oakland's Glen Head deposits were not made in the regular course of Oakland's business. The court nevertheless dismissed the complaint on the ground that "[t]he test [for determining whether a 'deposit' really is a 'transfer'] is not whether the deposits were made in the depositor's regular course of business, but instead, whether they were accepted by the bank in its regular course of business."

We hold that the legal standard articulated by the district court was erroneous. We further hold that, whether under the standard articulated by the district court or under the correct standard, the bank's motion for summary judgment should have been denied because there remained triable issues of fact, including whether the bank was aware of Oakland's intentional build-up of its account as reflected in the bank's acceptance of the deposits other than in the bank's regular course of business.

II.

Section 60(a) defines a preference in terms of six key elements.[3] Only one is of concern here. The district court

3. The statute, note 1 *supra*, states that a preference exists only if all six statutory elements are present:

"(1) There must be a transfer of the debtor's property, (2) to or for the benefit of a creditor, (3) for or on account of an ante-

(footnote continued on next page)

assumed that elements (2)-(6) of §60(a) were present. We likewise assume that the trustee, if afforded the opportunity at trial, could prove elements (2)-(6) in Oakland's series of deposits in its Glen Head account. The only remaining issue is the requirement of element (1) that there be a "transfer"[4] of the debtor's property.[5]

The district court concluded that there had been no transfer because Oakland deposited its funds in an ordinary checking account from which it could make withdrawals, until the bank imposed the freeze on June 29, 1971. In view of this factor, and because the court concluded that the trustee could not prove any agreement or complicity between Oakland (Brede) and the bank with regard to building up the account, the court concluded that

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cedent debt; (4) the transfer must be made or suffered while the debtor is insolvent, (5) within four months of bankruptcy; and (6) the effect of the transfer must be to enable the creditor to obtain a greater percentage of his debt than another creditor of the same class." *Mayo* v. *Pioneer Bank & Trust Co.*, 270 F.2d 823, 834-35 (5 Cir. 1959); 3 Collier on Bankruptcy §60.02, at 758-59 (Moore ed. 1976).

4. The statute, note 1 *supra*, defines "transfer" broadly. It is meant to preclude ingenious methods of circumvention:

> "All technicality and narrowness of meaning is precluded. The word is used in its most comprehensive sense, and is intended to include every means and manner by which property can pass from the ownership and possession of another, and by which the result forbidden by the statute may be accomplished. . . ." *Pirie* v. *Chicago Title & Trust Co.*, 182 U.S. 438, 444 (1901).

Accord, *National Bank of Newport* v. *Herkimer Bank*, 225 U.S. 178, 184 (1912).

5. The district court focused on the set-off itself and inquired whether *it* constituted a transfer. The district court did not explicitly consider whether the *deposits* amounted to transfers within the meaning of the Bankruptcy Act. We shall include in our analysis whether the deposits were transfers, as have most of the courts in similar cases.

the relationship between Oakland and the bank did not differ from an ordinary debtor-creditor relationship. This was the predicate for its conclusion that Oakland's deposits were not transfers within the meaning of §60.[6]

It is well settled that deposits in an unrestricted checking account, made in the regular course of business, do not constitute transfers within the meaning of the Bankruptcy Act. *New York County Bank* v. *Massey*, 192 U.S. 138, 145 (1904); *Jensen* v. *State Bank of Allison*, 518 F.2d 1, 4 (8 Cir. 1975); *Farmers Bank* v. *Julian*, 383 F.2d 314, 324 (8 Cir.), *cert. denied*, 389 U.S. 1021 (1967); *Joseph F. Hughes & Co.* v. *Machen*, 164 F.2d 983 (4 Cir. 1947), *cert. denied*, 333 U.S. 881 (1948); *Cusick* v. *Second National Bank*, 115 F.2d 150, 151-52 (D.C. Cir. 1940); *Frankford Trust Co.* v. *Comber*, 68 F.2d 471, 472 (3 Cir. 1933); *Citizens' National Bank of Gastonia* v. *Lineberger*, 45 F.2d 522, 526-27 (4 Cir. 1930). The theory of these cases is that a deposit creates a debt owed to the depositor by the bank and does not constitute a parting with property by the depositor. As the court said in *Lineberger, supra*, 45 F.2d at 527:

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6. We agree with the trustee's subordinate contention on appeal, as an alternative to its main contention that the court applied an erroneous legal test, that the bank should not have been granted summary judgment even under the test articulated by the court. The trustee's allegations about Famighetti's continuous knowledge of the course of Oakland's accelerating financial difficulties and his communications with Brede, if proven, would satisfy the requirement of the district court's legal test that there be dealings outside the regular course of the bank's business or complicity between Brede and the bank. These allegations raised a sufficient question of fact to make summary judgment inappropriate even under the district court's test.

> "A deposit in a bank . . . does not deplete the estate of the depositor, but results in substituting for currency, bank notes, checks, drafts, and other bankable items a corresponding credit with the bank, which may be checked against . . . . A deposit of funds differs from a payment in the essential particular that it is withdrawable at the will of the depositor."

All of the courts that have relied on a debtor-creditor relationship between bank and depositor to preclude a finding of a transfer have emphasized not only the requirement that the funds be withdrawable at the will of the depositor but also the requirement that the deposits be made in the regular course of business. See, eg., *Maye* v. *Pioneer Bank & Trust Co., supra,* 270 F.2d at 836. Various irregularities might defeat the presumption that deposits ordinarily do not have the effect of diminishing the bankrupt's estate and therefore are not transfers. Certainly when withdrawals are not permitted the deposits constitute payment, for they cannot be said to be in the regular course of business or to establish a mere debtor-creditor relationship between the bank and the depositor. E.g., *Mechanics' and Metals National Bank* v. *Ernst,* 231 U.S. 60, 67 (1913). But the fact that withdrawals *are permitted* does not make mandatory the opposite conclusion that the deposits *cannot* be considered transfers. See *Merrimack National Bank* v. *Bailey,* 289 F. 468, 470 (1 Cir.), *cert. denied,* 263 U.S. 704 (1923).[7]

7. In *Merrimack, supra,* 289 F.2d at 470, the First Circuit rejected the bank's arguments which were similar to those of the bank in the instant case:

> "On analysis, the [bank's] claim falls little short of contending that a creditor-depositor bank cannot become a preferred

(footnote continued on next page)

In deciding whether a bank's set-off is a "transfer", a court must determine from all the circumstances whether the deposits were made in the regular course of business. In view of the purpose of the inquiry, it does not make sense to consider only the bank's course of business. If the deposits somehow are out of the regular course of the depositor's business, the bank's normal procedures, or the usual course of dealings between the depositor and the bank, then an inference can be drawn that the deposits were not ordinary deposits but served to transfer the depositor's property to the bank. By limiting its inquiry to the regular course of the bank's business, the district court below failed to take into account that "a deposit may be made the cloak for some other transaction, such as payment or the giving of security; and in such case equity, which looks through form to substance, will treat the transaction according to its real nature." *Citizens' National Bank of Gastonia* v. *Lineberger, supra,* 45 F.2d at 527-28.

The bank insists here that a deposit will constitute a transfer under §60(a)(1), only if the trustee can prove the bank's complicity in, agreement to, or conscious awareness

creditor, because it may honor checks on the deposits . . . . We cannot accept this proposition. The fact that such bank creditors may honor checks on such deposits does not control. In this case, checks to cover these deposits were not drawn and paid . . . .

Bank creditors are subject to exactly the same rule of law as to preferences and set-off as are merchandise and other creditors. The different relations arising out of the fact that a bank creditor is also commonly a depositor debtor may require a somewhat different assessment and application of the evidential facts. But in all such cases of preference by set-off the fundamental question is one of fact . . . ."

of, the build-up in the account in anticipation of a set-off. That is not the law. If it were, equity would be precluded from looking through form to substance—even in a case of as blatant a preferential transfer as that alleged by the trustee here.

In many cases a bank has been held to be privy to the building up of a depositor-debtor's account and therefore not to have accepted or received the deposits in the regular course of business. E.g., *Mayo* v. *Pioneer Bank & Trust Co., supra,* 270 F.2d at 834; *Bank of Commerce* v. *Hatcher,* 50 F.2d 719 (4 Cir. 1931); *Blue* v. *Herkimer National Bank,* 30 F.2d 256 (2 Cir. 1929), *cert. denied,* 281 U.S. 750 (1930); *Elliotte* v. *American Savings Bank & Trust Co.,* 18 F.2d 460, 462 (6 Cir. 1927); *Bank of California* v. *Brainard,* 3 F.2d 3, 4 (9 Cir. 1925); *In re Almond-Jones Co.,* 13 F.2d 152, 156 (D. Md. 1926), *aff'd sub nom. Union Trust Co.* v. *Peck,* 16 F.2d 986 (4 Cir.), *cert. denied,* 273 U.S. 767 (1927); cf. *Goldstein* v. *Franklin Square National Bank,* 107 F.2d 393 (2 Cir. 1939) (case remanded for factfinding as to the bank's intent in accepting deposits and its knowledge of the depositor's insolvency), *on remand,* 31 F.Supp. 66 (E.D. N.Y. 1940) (findings of no intent to set off deposits against debt *and* no reasonable cause to believe depositor was insolvent). A bank's participation in the build-up, however, is not a prerequisite to a finding that there has been a transfer. The question has been posed as whether the account of the bankrupt was built up "with the understanding of the Bank". *Farmers Bank of Clinton* v. *Julian,* 383 F.2d 314, 324 (8 Cir.), *cert. denied,* 389 U.S. 1021 (1967); see *Jensen* v. *State Bank of Allison,* 518 F.2d 1, 4 (8 Cir. 1975). The query in each of those cases amounted to dictum because there was *no* evidence that the funds were accepted

by the bank *or* deposited by the bankrupt other than in the regular course of business of either. In both *Julian* and *Jensen,* upon which the district court relied, the bank accounts were long-standing, active accounts; in each case the Eighth Circuit emphasized that there was no intent on the part of the depositor *or* the bank, let alone an agreement between them, to use the deposits as a cloak for payment of a debt. We find those cases to be distinguishable from and therefore not controlling on the issue presented by the instant case.

Here the trustee alleged facts from which it could be inferred that the bankrupt did not make the deposits in its Glen Head account in good faith; that the deposits were not made in the regular course of its business, which already had practically ceased functioning, see *Merrimack National Bank* v. *Bailey, supra,* 289 F. at 470; *Cardozo* v. *Brooklyn Trust Co.,* 228 F. 333, 334 (2 Cir. 1915); that the deposits were unusual in the course of dealings between Oakland and the bank; and that Brede intended the deposits to serve as payment of his company's indebtedness to the bank. The bank's contention that the intent of the depositor is irrelevant misses the point.[8] If all six elements

8. The Supreme Court has recognized the significance of the intent of a depositor in making deposits which later are challenged as preferences. See *Mechanics' and Metals National Bank* v. *Ernst,* 231 U.S. 60, 67 (1913); *Studley* v. *Boylston National Bank, supra,* 229 U.S. at 526, 527, 529. In *Cusick* v. *Second National Bank, supra,* 115 F.2d at 152, the court stated that a deposit may be a preferential transfer if "either the [depositor] or the Bank, at the time of the deposits, intended them to operate as a payment of the notes . . . ." The rule as stated in *Cusick* was reaffirmed in *Mayo* v. *Pioneer & Trust Co., supra,* 270 F.2d at 836.

The question of the true nature of deposits calls to mind the query whether there is a sound when a tree falls in a forest (of oak[es] or

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of a preference under §60(a) exist, a preference will be found despite lack of intent on the part of the bankrupt to effect a preference. Here, the intent of the depositor is relevant in proving one element of a §60(a) preference—that the deposits were transfers—by showing that Brede never intended to withdraw the funds. If a depositor fully intends to leave the deposits in the account, available for set-off, they constitute payments on account of an antecedent debt whether or not at the time the deposits are made the bank knows it.[9]

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just timbers) with no one near enough to hear it. Fortunately the purposes of the Bankruptcy Act point to the practical conclusion that when a depositor intends not to withdraw deposits those deposits should be treated as transfers for purposes of §60(a). The trustee, of course, must prove such a state of affairs or of mind, just as he must prove the existence of each of the other statutory elements of a preference. See *Farmers Bank* v. *Julian, supra,* 383 F.2d at 324.

9. The bank's insistence here that there can be no transfer unless the bank is implicated in or aware of the build-up confounds the separate distinct requirements of §60(a) and §60(b). These sections have different elements because they have different functions in the scheme of the Act: both are concerned with a preference, but "[s]ubdivision (a) defines what shall constitute it and subdivision (b) states a consequence of it—gives a remedy against it." *Pirie* v. *Chicago Title & Trust Co., supra,* 182 U.S. at 446. Knowledge or notice on the part of the recipient of an alleged preferential transfer is an element of §60(b), see note 1 *supra,* but not of §60(b). *Pirie, supra,* 182 U.S. at 446.

Matters v. *Manufacturers' Trust Co.,* 54 F.2d 1010 (2 Cir. 1931), is not to the contrary. There, in holding a bank deposit to be a preference under N.Y. Stock Corporation Law §15, Judge Learned Hand stated that the New York statute differed from the federal Bankruptcy Act in that the latter "charge[s] the transferee only when in privity with the transferor; . . . if there is to be a recovery, the bank must understand that the account is being built up so as to be available at the proper time for seizure." *Id.* at 1013. Aside from the fact that this statement was dictum since the holding was based on

(footnote continued on next page)

III.

We have considered the bank's other arguments and find them to be without merit.[10]

New York law alone and not on §60 of the Bankruptcy Act, the interpretation of the federal law is consistent with what we hold here. The knowledge to which Judge Hand adverted was the "reasonable cause to believe" requirement of §60(b), which then was phrased to require that the transferee "have reasonable cause to believe that the . . . transfer would effect a preference." Bankruptcy Act §60(b), as amended June 25, 1910, 36 Stat. 842. This is confirmed by Judge Hand's citation to *Kolkman* v. *Manufacturers' Trust Co.,* 27 F.2d 659 (2 Cir. 1928), another case under N.Y. Stock Corporation Law §15, where the Court held the innocence of the bank to be irrelevant under §15. The innocence of the bank was described in terms which indicated that the Court had in mind the "reasonable cause to believe" standard of §60(b): "[The insolvent's check] was received in regular course of business . . ., the bank acting throughout in good faith and without knowledge of the financial difficulties of its depositor." *Id.* at 660.

Furthermore, Judge Hand's comments in *Matters* assumed that the deposit was one "over which the depositor means to keep full control". 54 F.2d at 1013. In such a case, as we have discussed above, the only practical way to prove that the deposits were outside the regular course of business is to prove that "the bank must understand that the account is being built up so as to be available at the proper time for seizure." *Id.*

10. For example, whether the bank had reasonable cause to believe that Oakland was insolvent is something that the trustee must prove at trial and is a question for the jury.

The bank also contends that it was Brede, not the bank, who received a preference. Even if Brede as guarantor of Oakland's note received a preference, that does not necessarily preclude a finding that the bank received one. In *Citizens' National Bank of Gastonia* v. *Lineberger, supra,* and in *Joseph F. Hughes & Co.* v. *Machen, supra,* the Fourth Circuit held that there had been no "transfer" to the banks because the deposits had been made and accepted in the regular course of business. The court reasoned, a fortiori, that there had been no preferential transfers to the guarantors of the depositors' notes. The court responded to the trustees' arguments that there had been preferences to the guarantors by saying that perhaps that would be the case if the funds had been deposited in the accounts with the intent to effect a preference. These cases do not hold that in such a situation the banks would not have received preferences. In the instant case, the trustee is entitled to prove, if he can, that the bank and Brede have been preferred and have diminished the assets of the bankrupt's estate, to the detriment of the other creditors.

Nothing in this opinion is intended to express or imply any views on the part of the Court with respect to the result to be reached by the district court on remand. All we hold is that the trustee is entitled to his day in court and an opportunity to prove, if he can, a preferential transfer under §60 of the Bankruptcy Act in accordance with the correct legal standard as stated in this opinion.

Reversed and remanded for trial.

VAN GRAAFEILAND, *Circuit Judge*, concurring in part and dissenting in part:

I concur with the majority that the granting of summary judgment was error and that this matter must be remanded for a full development of the facts on trial. However, I cannot agree with the majority's exposition of the law to be applied by the district court on remand.

The issue in this case is a simple one: *viz.*, were the deposits by Oakland in its checking account "transfers" within the meaning of §1(30) of the Bankruptcy Act? 11 U.S.C. §1(30). The majority holds that a unilateral decision by a depositor not to exercise his right to draw checks against his account transforms the bank, without its knowledge, from a debtor to a transferee.[1] This does not accord with the "traditional rule" which is correctly set forth at the outset of the majority opinion; *i.e.*, "that in order to prove a voidable preference the trustee must show complicity or understanding on the part of the bank."

1. The majority does not state whether the depositor can "untransfer" the transferred funds if he changes his mind and decides to draw checks against his account.

In the leading case of *New York County National Bank* v. *Massey*, 192 U.S. 138, 147 (1904), the Court held that "a deposit of money to one's credit in a bank does not operate to diminish the estate of the depositor, for when he parts with the money he creates at the same time, on the part of the bank, an obligation to pay the amount of the deposit as soon as the depositor may see fit to draw a check against it." Until the bank acts to restrict the right of the depositor to write checks against the account, the money on deposit remains the property of the depositor and he may draw against it. *United States* v. *Sterling National Bank & Trust Co.*, 494 F.2d 919, 922 (2d Cir. 1974).

The *Massey* court held that in the absence of a showing of fraud or collusion between the bankrupt and the bank aimed at creating a preferential transfer of the bankrupt's property, the deposits which he makes create an indebtedness on the part of the bank and do not diminish the bankrupt's estate. This holding requires, at the least, that there be some participation or understanding on the part of the bank before an ordinary deposit can be considered a transfer, and this is the generally accepted rule. 4 *Collier on Bankruptcy*, § 68.16 at 919-21; 3 *Remington on Bankruptcy* § 1474.4 at 472 (J. Henderson rev. 1957). We have accordingly stated that where a bank accepts a deposit with the intention of applying it on a preexisting claim against the depositor rather than holding it subject to his right of withdrawal, there may be a voidable preference. *See Miller* v. *Wells Fargo Bank International Corp.*, 540 F.2d 548, 557 (2d Cir. 1976), (citing *Goldstein* v.

Franklin Square National Bank, 107 F.2d 393, 394 (2d Cir. 1939)). The test, as set forth in *Goldstein,* is whether the bank, in receiving the deposits, intends to apply them in payment or setoff of an outstanding indebtedness of the depositor. Expressed another way, the test is "[w]as the account of the bankrupt built up, with the understanding of the Bank, for the purpose of allowing the Bank to use it as an offset and thereby obtain a preference?" *Farmers Bank* v. *Julian,* 383 F.2d 314, 324 (8th Cir.), *cert. denied,* 389 U.S. 1021 (1967).

Although the majority's attempt to do equity will penalize only the bank in the instant case, the burden of the rule which we now lay down will fall in the long run upon the depositor. A bank is not simply a repository of funds; it is a source of credit. The facts of financial life are such, however, that the businessman seeking credit is most likely to secure it at the bank where he is a depositor. H. Justman, *Comments on the Bank's Right of Setoff under the Proposed Bankruptcy Act of 1973,* 31 *Bus. Law.,* 1607, 1611, & 1616 n.54 (1976). This bank not only has the use of the deposited funds; it also has the right of setoff. *Jensen* v. *State Bank,* 518 F.2d 1, 4 n.6 (8th Cir. 1975). The maintenance of an adequate balance in his demand account benefits the depositor as well as the bank, because the bank's right of setoff encourages it to continue credit when it might be induced otherwise to call its loans. If a businessman's efforts to create and maintain an adequate balance are, standing alone, to be construed as transfers of the funds involved, an inducement for the bank to work along with the financially troubled entrepreneur is removed. It

was to encourage such cooperation that the bank's right of setoff was preserved when the Bankruptcy Law was amended by the Chandler Act in 1938. *See* 4 *Collier on Bankruptcy,* §68.01(3). A right which Congress has refused to eliminate should not be eliminated by this Court in its stead.

I see no reason why the district court should be directed to depart from the rule laid down by this Court in *Goldstein, supra,* and approved only last year in *Miller, supra.*

41

Memorandum and Order of District Court

(Filed October 22, 1976)

Pratt, J.

On June 30, 1971, defendant bank exercised its right of set-off against a checking account having a balance in favor of Oakland Foundry of Belleville, Illinois, Inc. in the amount of $108,783.91. These funds were applied against Oakland's indebtedness to the bank in the amount of $125,000. Fifteen days later, on July 15, 1971, an involuntary petition in bankruptcy was filed against Oakland in the United States District Court for the Eastern District of Illinois. Plaintiff seeks to invalidate that set-off as a voidable preference under 11 USC §96.

The following facts are undisputed, having been expressly asserted by defendant for purposes of the motion under local rule 9(g) and expressly admitted by plaintiff in his answering papers:

1. On or about January 16, 1969, in consideration of a loan from the Bank in the amount of $125,000, Oakland Foundry of Belleville, Illinois, Inc. ("Oakland") executed a promissory note in favor of the Bank for the sum of $125,000. The promissory note matured on April 16, 1969 and was thereafter renewed quarterly until June 18, 1970, when Oakland's obligation was made payable on demand. Affidavit of Anthony D. Famighetti, ¶2, Exhibit A ("Affidavit"), sworn to June 23, 1976.

2. Electronic Cabinets, Inc., Herman Brede and his wife, Betty D. Brede, guaranteed Oakland's indebtedness to the Bank. Affidavit, Exhibit B. The Bank ordinarily required a personal guaranty on a corporate

borrowing by a small, individually held corporation such as Oakland. Without a personal guaranty, the Bank would not have made the loan to Oakland. Affidavit, ¶3.

3. In addition, Oakland secured its indebtedness and the guarantors secured their obligation by pledging with the Bank all of the stock of Electronic Cabinets, Inc. and H. W. Brede Co., Inc. Affidavit ¶4; Transcript of Testimony of Herman W. Brede, October 12, 1971 ("Brede Testimony"), at 7.

4. Oakland was a wholly-owned subsidiary of Electronic Cabinets, Inc., and Mr. and Mrs. Brede were the sole stockholders of Electronic Cabinets, Inc. and of H. W. Brede Co., Inc. Brede Testimony at 14-15. Mr. Brede was the president and chief executive officer of Oakland. Brede Testimony, at 5.

5. On June 18, 1970, at the time the parties converted Oakland's promissory note to a demand note, Mr. and Mrs. Brede gave the Bank additional security in the form of a second mortgage on their residence. Affidavit ¶6, Exhibit D.

6. At the time of the Bank's loan to Oakland, Oakland opened a general checking account with the Bank (the "Glen Head Account"). Affidavit, ¶7, Exhibits E and F. The Glen Head account was a general account, and there were no restrictions on Oakland's right to make withdrawals. Affidavit ¶7.

7. Oakland maintained accounts at the St. Clair National Bank of Belleville, Illinois (the "St. Clair Account") and the Trade Bank & Trust Company of New York. Affidavit ¶8; Brede Testimony, at 8-9.

11. Oakland made deposits in the total amount of $47,738.56 in April of 1971, $48,105.05 in May of 1971, and $12,075.21 in June of 1971. Affidavit, Exhibit H.

12. In "June or July", Herman W. Brede, President of Oakland, telephoned Anthony D. Famighetti at the Bank in order to advise that Oakland was in "financial trouble". In that conversation, Mr. Brede stated that he "was going to talk to the other creditors to tell them that [he] was in trouble • • • [and] was still trying to work [his] way out of it." Brede Testimony, at 10-12.

13. The foregoing conversation between Mr. Brede and Mr. Famighetti, then the Bank's President (now Chairman of the Board and Chief Executive Officer), occurred on June 29, 1971. Affidavit ¶14, Exhibit I.

14. As a result of the conversation between Mr. Brede and Mr. Famighetti on June 29, 1971, the Bank, on June 30, 1971, set-off Oakland's funds in the Glen Head Account on June 30, 1971, which totalled $108,-783.91. These funds were applied against Oakland's indebtedness to the Bank in the amount of $125,000.00. Affidavit, ¶15, Exhibits J and K.

15. On July 15, 1971, an involuntary petition in bankruptcy was filed against Oakland in the United States District Court for the Eastern District of Illinois. Plaintiff's Answers to Defendant's Interrogatory No. 1. Subsequently, Oakland was adjudged bankrupt on August 18, 1971. Complaint, ¶5.

16. Donald Katz, the plaintiff herein, was appointed trustee in bankruptcy for the Oakland estate on or about October 12, 1971. Complaint, ¶5.

17. On October 12, 1971, counsel (now counsel to the trustee) for the receiver (now trustee) of the Oakland estate examined Mr. Brede, Oakland's President, in the bankruptcy court, under oath pursuant to Section 7a(10) of the Bankruptcy Act, 11 U.S.C. §25(10).

For purposes of this motion I have assumed that at the time of the set-off Oakland was insolvent and that the bank had reasonable grounds to believe that Oakland was insolvent. Since the set-off was by definition for the benefit of a creditor, the bank, on account of an antecedent debt, since it occurred within four months of bankruptcy, and since its effect enabled the bank to obtain a greater percentage of its debt than other creditors of the same class, it follows that all the elements of a voidable preference under §96 are present *if* the set-off itself constituted a "transfer" of Oakland's property.

The general law has been accurately summarized in 4 Collier on Bankruptcy §68.16 as follows:

> The general rule may first be stated that where an insolvent depositor makes general deposits within four months of his bankruptcy, which deposits are accepted in good faith and in the regular course of business, the bank has a right to setoff such deposits against an obligation owing to it by the depositor. Obviously, where the bank has no knowledge or imputation of knowledge, or "reasonable cause to believe", that the depositor is insolvent, such routine deposits are clearly available as set-offs. *But even though the depositor was insolvent and knowledge of this fact could be charged against the bank at the time when the deposit was made, the bank is still entitled to apply the deposit on its claim, so long as it was accepted in good faith, in the ordinary course of business.* It is only where affairs have reached such a point that the bank accepts

> the deposit for the purpose of payment, or of giving itself a subsequent advantage over other creditors through its right of set-off, or for some other special purpose, that the deposit and the subsequent application of it amounts to a recoverable preference. (At pp 917-920.1; emph. supp.)

A few pages later, discussing the requirement that the deposits be accepted in good faith and in the ordinary course of business, the author further states:

> The usual general deposits made on an open checking account subject to withdrawal at will constitute the type of deposits which will more often be considered above suspicion. But if the deposits are not accepted in the ordinary course of business, or are procured, accepted or "built-up" for the real purpose of permitting the bank to obtain a set-off, the deposits will be considered voidable preferential transfers and the right of set-off is lost. (At pp 923-925).

In *Jensen* v. *State Bank of Allison*, 518 F2d 1 (CA8 1975), bankruptcy trustee sought to vacate a set-off by the bank. As here, there was no evidence of the bank's complicity in a build-up of the depositor's account, or that the deposits had been accepted in order to permit the bank to obtain a preference. The account was one of long standing. The court noted that "[u]nder the Bankruptcy Act, no voidable preference is ordinarily created when a bank sets off funds in an account of general deposit with it against the debt owed it by the depositor". 518 F2d at 4.

In *Farmers Bank* v. *Julian*, 383 F2d 314, 325 (CA8 1967), the court stated:

> Section 68(a) of the Bankruptcy Act, 11 U.S.C. §108, applies and allows a setoff to [a] Bank unless the account has been accepted or built up for the real purpose of permitting the Bank to obtain a preference by way of setoff of the account. A bank account at the time of filing the petition in bankruptcy is a debt due to the bankrupt from the bank, and in the absence of fraud or collusion between the Bank and the bankrupt, the Bank may set the account off against any indebtedness owed it by the bankrupt. * * * The bank has the right to set off deposits against indebtedness even though the bankrupt is insolvent at the time of setoff and before the petition in bankruptcy is filed.

Further in *Farmers Bank* v. *Julian, supra*, the court stated the issue as follows:

> The issue is: Was the account of the bankrupt built up, *with the understanding of the Bank*, for the purpose of allowing the Bank to use it as an offset and thereby obtain a preference? 384 F2d at 324 emph. supp.

In the present case Herman Brede, President of Oakland, had personally guaranteed, together with his wife, the corporate obligations to the bank. From the fact that approximately $107,000 was deposited by Oakland in the general checking account in the bank, one might infer that Brede had intended to make those funds available for a set-off in the event of a bankruptcy. The key to the problem here, however, is that there is nothing presently in the record or which might be available to the plaintiff on a

trial to show any complicity by the bank in such an intention.

Insofar as the bank's actions are concerned, up until June 30, 1971, when its right of set-off was exercised, the funds which had been deposited by Oakland in its open checking account were available for withdrawal. There is nothing to show that the bank engaged in any collusion with Brede or Oakland, that it in any way isolated or liened the funds in Oakland's checking account, or treated the transactions in any way different from any other general checking account. Under such circumstances the bank had a right of set-off and its exercise thereof did not constitute a voidable preference.

Pinpointing the issue somewhat more narrowly, the cases seem to say that a bank's set-off of a general checking account will not constitute a viodable preference if the deposits were built-up or accepted in the regular course of business. The question arises: whose business? the bank's? or the depositor's? The trustee argues that this set-off must be voided if the deposits were not made by Oakland in the regular course of its business. I disagree, and for purposes of this motion, I have assumed that the deposits were *not* made by Oakland in the ordinary course of its business, but were instead made either to isolate funds from its Illinois creditors, or to place funds within easy reach of the bank's right of a set-off, which, if exercised, would reduce Brede's potential liability on his personal guarantee to the bank.

Such action by the depositor alone is not enough to constitute a voidable preference. The test is not whether the

deposits were made in the depositor's regular course of business, but instead, whether they were accepted by the bank in its regular course of business. Viewed in that light, there is nothing in the record by which the trustee could establish on a trial that these deposits were received by the bank in anything other than its ordinary course of business. The funds were kept available in the checking account, ready to be withdrawn any time up until the right of set-off was exercised.

Upon the oral argument plaintiff's attorney conceded that if on the law relief required the bank's involvement in the build-up of the account, and if there was nothing in the papers before the court to create a question of fact as to the bank's participation, collusion or complicity in a plan by Brede to prefer the bank over other creditors, then summary judgment would have to be granted to the defendant. I have reviewed the papers submitted on the motion, including both the affidavit and deposition of Anthony D. Famighetti, president of the bank, and conclude that neither anything in the papers nor in Mr. Famighetti's testimony raises any issue of fact on the key question.

None of the cases cited by plaintiff involves situations where a set-off was invalidated in the absence of evidence indicating that the bank had received the deposits in a manner not constituting the ordinary course of business. Since plaintiff has been able to produce no such evidence here and indeed has conceded that all the evidence available to him is presently before the court, no purpose would be served by permitting this case to go to trial.

Memorandum and Order of District Court

Brede having disappeared, as noted by plaintiff's counsel on the argument, his testimony would not be available on a trial. Accordingly, summary judgment in favor of the defendant dismissing the complaint must be granted.

So Ordered.

Dated: Brooklyn, New York
October 19, 1976

/s/ George C. Pratt
U.S. District Judge

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1977

No. 77-918

THE FIRST NATIONAL BANK OF GLEN HEAD,
Petitioner,

v.

DONALD KATZ, Trustee in Bankruptcy of Oakland Foundry Company of Belleville, Illinois, Inc.,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR RESPONDENT IN OPPOSITION

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SUBJECT INDEX

CITATIONS

Cases

Statutes and Rules

Treatises

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1977

No. 77-918

THE FIRST NATIONAL BANK OF GLEN HEAD,
Petitioner,

v.

DONALD KATZ, Trustee in Bankruptcy of Oakland Foundry Company of Belleville, Illinois, Inc.,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Second Circuit, not yet officially reported, appears in Appendix I annexed to the petition. The opinion of the United States District Court for the Eastern District of New York, dated October 19, 1976, is officially reported at 424 F.Supp. 1174, and a copy thereof is annexed as Appendix II to the petition.[1]

[1] References to the opinions of the Court of Appeals and District Court opinions herein will be made by citation to the pagination of Petitioner's Appendices. (Pet. A. . . .)

JURISDICTION

The jurisdictional requisites are adequately set forth in the petition.

QUESTIONS PRESENTED

1. Whether a trustee in bankruptcy, seeking to set aside as a preference a bank's set-off of its bankrupt depositor's funds, who shows:

> (a) That a pre-bankruptcy build-up was made in a checking account that was opened and maintained as security for a loan from the bank to the depositor and not used for ordinary business purposes; and further shows
>
> (b) That the deposits constituting the build-up were neither made by the depositor nor accepted by the bank in the ordinary course of business; and further shows
>
> (c) That the bank had knowledge of the build-up, and of the depositor's financial difficulties and was in communication with the bankrupt immediately prior to set-off;

has produced sufficient evidence that the deposits were a transfer, and the bank a transferee under Section 60(a) of the bankruptcy act, to avoid summary judgment?

2. Whether the Second Circuit's alternative holding, that in determining whether the deposits were made in the ordinary course of business it is proper to review the ordinary course of the bankrupt depositor's business and his course of transactions with the bank, is consistent with prior holdings of this court?

3. Whether the Court of Appeals properly applied the law respecting summary judgment in reviewing the trustee's answering papers to the bank's motion for summary judgment?

STATUTES AND RULES INVOLVED

The pertinent statutes are set out in the Petition (Pet. 3-4).

STATEMENT OF THE CASE

The Petitioner Bank's statement of facts is "distilled from the opinions of the lower courts." (Petition p. 5). Had the bank looked to the record on appeal, however, it would have found substantial detailed evidence to sustain the findings of the Court of Appeals. The inadequacy of the fact statement provided by petitioner, as well as substantial misinterpretation by the bank of both the evidence and the holding of the Court of Appeals below, compel respondent, the trustee in bankruptcy, acting pursuant to Supreme Court Rule 24, to restate the evidence and course of proceedings below in detail in order to demonstrate the reasons why petitioner's petition for writ of certiorari should not be granted.

Respondent, Donald Katz, Trustee in Bankruptcy of Oakland Foundry Company of Belleville, Illinois, Inc., brought this action to set aside, as a voidable preference, a set off of $108,-783.91 from the bankrupt's account by the petitioner, First National Bank of Glen Head, pursuant to § 60 of the Bankruptcy Act, 11 U.S.C. § 96. It was the gravamen of the Complaint that $108,741.07 deposited by the Bankrupt into its previously inactive bank account during the 2½ months immediately preceding bankruptcy, was intended as a preferential payment of an outstanding indebtedness of the Bankrupt, which indebtedness was personally guaranteed and secured by the Bankrupt's President and owner, Herman Brede.

The District Court, in allowing petitioner Bank's Motion for Summary Judgment, assumed that at the time of the set off,

Oakland was insolvent and that the Bank had reasonable grounds to believe that Oakland was insolvent. The Court further recognized that the set-off was for the benefit of the creditor, was on account of an antecedent debt, was made within four months of bankruptcy, and enabled the Bank to obtain a greater percentage of its debt than other creditors of the same class. The Court held, however, that there was no transfer within the meaning of 11 U.S.C. § 96, since there was no evidence "to show any complicity by the Bank" in the bankrupt's president's scheme to make these funds available for a setoff in the event of impending bankruptcy.

The Court held that in determining whether the monies deposited in the Bank were built-up in the regular course of business, the proper test is only whether the deposits were accepted by the Bank in the regular course of its business. As the District Court stated:

> "The test is not whether the deposits were made in the depositor's regular course of business, but instead, whether they were accepted by the Bank in its regular course of business." (Pet A. 24-25)

Whether the deposits were made in the regular course of the Bankrupt's business, and whether they were made in the regular course of business between the Bank and the Bankrupt were held not relevant by the District Court.

The trustee appealed, contending (1) that the correct standard for determining whether the deposits were made in the ordinary course of business required inquiry into whether the deposits were made in the ordinary course of the bankrupt's business and in the ordinary course of transactions between the bankrupt and the bank; and (2) that no matter whose ordinary course of business is looked to, there was sufficient evidence in support of the trustee's case to go to trial, and it was therefore error to grant summary judgment against the trustee.

The Court of Appeals reversed. The panel was *unanimous* in concluding that the District Court erred in entering summary judgment. The entire panel agreed that even applying the District Court's "bank's only" ordinary course test, the trustee had presented sufficient evidence to allow the question whether there was a transfer within the meaning of § 60(b) of the Bankruptcy Act to go to trial.[2] And the majority of the panel, in an opinion by Judge Timbers, further concluded that

> "In view of the purpose of the inquiry, it does not make sense to consider only the bank's course of business. If the deposits somehow are out of the regular course of the depositor's business, the bank's normal procedures, or the usual course of the dealings between the depositor and the bank, then an inference can be drawn that the deposits were not ordinary deposits but served to transfer the depositor's property to the bank."

The entire court agreed to reversal and remand, and to the trustee's contention that its answering papers to the bank's motion for summary judgment had presented sufficient evidence to defeat the motion. The sole basis for difference of opinion within the court was the correct standard to be applied to the evidence at trial.

DETAILED FACTS BELOW

The facts from which the unanimous court concluded that summary judgment was improper all appear in the record, and are as follows:

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[2] The Court did not hold, as petitioner argues (Petition, p. 8) that the dopisits were transfers; the issue before the court was not whether a transfer had been made, but only whether the trustee had met his burden in responding to the bank's motion for summary judgment. Thus, the Court merely held that the trustee had shown enough evidence on the issue of whether there was a "transfer" to avoid summary judgment.

Oakland Foundry Company of Belleville, Illinois, Inc., the Bankrupt, was a wholly-owned subsidiary of Electronic Cabinets, Inc. All the stock of Electronic Cabinets, Inc., as well as all of the stock of H. W. Brede Co., Inc., was owned by Herman Brede and his wife, Betty, of Upper Brookville, New York. Brede was the President and Chief Executive Officer of Oakland Foundry.

Oakland maintained two checking accounts at the St. Clair National Bank of Belleville, Illinois, one checking account at the Trade Bank and Trust Company of New York (not pertinent to these issues), and one checking account at First National Bank of Glen Head, New York, which was opened on January 16, 1969.

The Loan Transaction

In consideration of a loan in the amount of $125,000.00, Oakland Foundry executed a Promissory Note in like amount in favor of First National Bank of Glen Head. This Note was executed on or about January 16, 1969, and matured on April 16, 1969. The Note was renewed quarterly until June 18, 1970, at which time Oakland's obligation was made payable on demand.

The Bank ordinarily required a personal Guarantee on corporate borrowings by small individually held corporations such as Oakland. In this instance, at the time the loan was made, Electronic Cabinets, Inc., Herman Brede and Betty Brede, each guaranteed Oakland's indebtedness to the bank. Without the personal guarantee of the Bredes, the Bank would not have made the $125,000.00 loan to Oakland.

Oakland's indebtedness to the Bank was further secured by a pledge to the Bank by the Bredes of all of the stock of Electronic Cabinets, Inc. and all of the stock of H. W. Brede Company, Inc.

On June 18, 1970, when Oakland's indebtedness was converted to a demand Note, as additional security on the loan, the Bredes gave the Bank a Second Mortgage on their Upper Brookville, New York, home.

On January 16, 1969, the same day that the Bank loaned Oakland $125,000.00, and pursuant to the Bank's usual practice, Oakland opened a general checking account with the Bank. The Bank did not pay interest on deposits in this account.

The Bank's Knowledge of Oakland's Financial Difficulties.

Before the Bank made the loan to Oakland, it was aware of the company's financial problems. It expressed concern that Oakland had turned only losses for the eleven months preceding the loan, and instead of loaning Oakland $250,000.00, as requested, loaned it only $125,000.00. The loan was made not on the strength of Oakland's capacity to repay it, but on Brede's individual financial strength apart from Oakland Foundry.

During the 2½ years following the loan and before Oakland's bankruptcy in July of 1971, the Bank continued its awareness of Oakland's financial straits. Anthony Famighetti, at all times here pertinent, the President of the First National Bank of Glen Head, testified that he knew that Oakland was having difficulties as early as 1970, and that he knew that Oakland had been operating for years on a continuing loss basis. Indeed, the reason the Bank required additional collateral from Oakland was because it knew that Oakland had not earned a profit during the several years prior to its 1971 bankruptcy. In June of 1970, at the time the second mortgage was taken on Brede's home, Oakland had an accumulated deficit of $300,000.00 and had lost $100,000.00 in the prior calendar year. The Bank's credit memo of June 18, 1970

reflects that even at that early date, the Bank advised Oakland that it "want[ed] out." In 1970, Famighetti was concerned about Oakland's cash flow, knew that Oakland owed $250,-000.00 to the Small Business Administration, and had total debts too heavy for it to carry. The Bank knew that Oakland had obtained loans to the legal limit in 1970, from the St. Clair National Bank in Belleville, Illinois where Oakland maintained two checking accounts and did most of its banking. The Bank also knew that Oakland was financing its receivables through a factoring organization. The Loan Committee of The First National Bank of Glen Head, in 1970, discussed Oakland's financial situation and its low working capital and knew of the low balance maintained in Oakland's Glen Head account. Famighetti admitted that the petitioner bank became aware of Oakland's "adverse financial condition" as its financial statements, which reflected the loss history, were received by the Bank. Additionally, Famighetti stated that he felt that Oakland was always in an adverse financial condition. He stated, specifically, that he was aware of Oakland's losses for the years 1968, 1969 and 1970.

The Bank had knowledge that Oakland gave false information in its Dun & Bradstreet Report for calendar 1970, the report representing sales of $1.4 million, and the income statement available to the Bank representing sales at only $546,000.00. The Dun & Bradstreet Report thus indicated sales in excess of 2.56 times the data available to the Bank.

In addition, Brede had been in close contact with the Bank respecting Oakland's obligation to the Bank during the few months immediately preceding the set-off, and the Bank had knowledge of Oakland's financial condition during those last few months as a result of discussions with Brede and one of Oakland's employees. In 1970, aware that the St. Clair National Bank and the Small Business Administration were creditors of Oakland, the Bank began asking that a substantial "compensating balance" be maintained in the Oakland checking account. The reason the Bank's President gave for making such a demand was "to be sure that we weren't left out in the cold, since we were extending substantial dollars, too."

The Ordinary Course of Business of Oakland and the First National Bank of Glen Head.

By March, 1971, Oakland had ceased normal, ordinary business operations.

Until February, 1971, Oakland regularly met its factory and office payrolls. In March, 1971, a much smaller factory payroll was met, and some back-payments were made on the factory payroll. In addition, a reduced office payroll was met that month. In April, 1971, no factory payroll whatsoever was reflected, and the reduced office payroll was met. By June, 1971, the office payroll was further reduced, and the factory payroll again was not evident.

Although the Bank has taken the position in this litigation that the checking account which Oakland maintained with it was a general business account, Famighetti testified that the Bank was not aware of what types of obligations the checks on the Glen Head account and the St. Clair account were used to pay. In fact, virtually all of the routine banking done by Oakland was done through its two accounts at St. Clair National Bank of Belleville.

The character of Oakland Foundry Company's "ordinary course" business transactions can best be understood by a study of activity in its main bank checking accounts. Two of these checking accounts were with St. Clair National Bank of Belleville, Illinois. One was the Foundry's regular account and the other was the Foundry's payroll account. The St. Clair Bank was located within one mile of Oakland Foundry's place of business. The third account was that with the petitioner, First

National Bank of Glen Head, New York, that was opened as a condition to the bank making the $125,000 loan.

A review of the transactions between Oakland and the First National Bank of Glen Head shows that from July of 1970, through March of 1971, a modest balance of between $1,300.00 and $5,800.00 was maintained in that account. Deposits were occasionally made, as were withdrawals, but by and large the account was inactive. In July 1970, no checks were drawn on this account. In August 1970, three checks were drawn. The records of September of 1970 through April of 1971, a period of eight months, reflect only minimal activity in the Glen Head account.[3]

The Build-Up.

The pattern changes markedly on or about April 20, 1971. During the next two weeks enough deposits were made in the Glen Head account to bring the balance from $865.09 to $68,603.65 by the end of April. In May of 1971, further deposits were made bringing the balance in the Glen Head account to $102,066.14. In June, eleven deposits were made in the Glen Head account bringing the balance therein to $109,348.66 according to records of Bankrupt. On the first of July,

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[3] From September, 1970, to April, 1971, the only transactions in the Glen Head account consisted of the following:

1. A check from the Glen Head account, payable to Glen Head on October 15, 1970;

2. A withdrawal of $300.00 on November 20, 1970;

3. A deposit of $3,000.00 on January 25, 1971, and a simultaneous withdrawal payable to First National Bank of Glen Head for interest of $2,656.25 on January 25, 1971;

4. A deposit of $2,922.79 on March 8, 1971; and on April 13, 1971, a check in the amount of $2,656.25, payable to Glen Head for interest; and

5. On April 15, 1971, a check to Dun & Bradstreet in the amount of $792.40.

After charging Oakland's account with those last two checks, the balance was a meager $865.09.

one final deposit was made into the Glen Head account, bringing the amount of money in the account (without considering the setoff by the Bank on June 30) to $109,597.16.

This final deposit was made *after* Brede's June 29 call to Famighetti in which Brede told Famighetti that Oakland was experiencing "complications" with its creditors. This final deposit was also made *after* Famighetti ordered that payment was not to be made on checks drawn on Oakland's account.

Thus from April 15, 1971, when the balance was $865.09, in a period of 2½ months, a total of $108,732.07 was placed in the account.[4] During that 2½ months, no withdrawals at all were made until the defendant set off the account in the amount of $108,783.91 on June 30.

Defendant argued below, and contends here, that this account, on which no checks at all were written for 2½ months, was a regular checking account used for everyday business purposes.

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[4] The deposits which constituted the build-up were as follows:

Date	Amount of Deposit
4/20/71	$ 2,546.63
4/21/71	2,071.00
4/26/71	43,120.93
4/28/71	20,000.00
5/04/71	4,681.76
5/07/71	668.81
5/18/71	21,451.01
5/25/71	1,303.47
5/28/71	5,357.44
6/01/71	484.94
6/05/71	1,588.68
6/07/71	688.83
6/09/71	982.05
6/14/71	898.68
6/10/71	9.70
6/21/71	820.17
6/25/71	1,157.50
6/29/71	88.22
6/22/71	19.00
6/30/71	564.75
7/01/71	248.50

From January 1, 1971 to July 15, 1971, a period of six and one-half months, only three checks were drawn on the First National Bank of Glen Head by Oakland, and two of these were to pay interest to Glen Head on the outstanding obligation of the Bankrupt.

Oakland's Ordinary Course of Banking With St. Clair National Bank.

One need only view the Bankrupt's regular bank account at the St. Clair National Bank of Belleville for the same period of time to see that virtually all of Oakland's routine business was processed through this account.[3] Between July, 1970 and May, 1971, the bankrupt made 112 deposits, and drew 891 checks. These checks were drawn for the purpose of paying payables, transfer funds for payroll to the payroll account, taxes, operating expenses and other items connected with the "ordinary" operation of Bankrupt's business.

The Set-Off.

First National Bank of Glen Head, of course, had full knowledge of the character of the acivity in Oakland's account with

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[3] A review of the bankrupt's banking records with the St. Clair National Bank shows the following transactions:

	Number of Checks	Number of Deposits
July, 1970	149	16
August, 1970	58	8
September, 1970	118	11
October, 1970	78	17
November, 1970	120	17
December, 1970	65	8
January, 1971	43	8
February, 1971	112	10
March, 1971	66	10
April, 1971	49	6
May, 1971	33	1
TOTAL	891	112

it. Famighetti admitted observing the build up himself, and the Bank knew how few withdrawals were being made on the account, knew the nature of at least some of those withdrawals, since most were to pay interest to the Bank itself, and knew that such was not the pattern of an ordinary business account.

On June 29, 1971, Brede called Famighetti to tell him that Oakland was in financial trouble, and that he was going to call his other creditors and try to work his way out. Famighetti immediately placed a freeze on Oakland's account, barring all withdrawals. The next day, on June 30, 1971, the petitioner, First National Bank of Glen Head, set off the sum of $108,783.91 and applied it against the outstanding loan balance of Oakland in the amount of $125,000.00.

Oakland Foundry was adjudicated a Bankrupt on August 18, 1971, pursuant to an "Involuntary" Petition which was filed against it on July 15, 1971, just two weeks after the Bank set off the funds in the account against Oakland's outstanding debt. Brede subsequently paid off the remainder of the obligation.

REASONS FOR DENYING THE WRIT

I

This Case Turns on Its Own Narrow Facts: the Court of Appeals Correctly Held That There Is a Fact Question Presented as to Whether the Deposits Were Made and Accepted in the Ordinary Course of Business, Thus Summary Judgment Was Improperly Entered.

The writ should be denied because the decision and disposition below are premised on the specific facts of this case, and do not present issues of general importance to bankruptcy jurisprudence. The Court of Appeals recognized that in determining whether Oakland and Glen Head had a traditional debtor-creditor relationship, or whether the bank, in accepting Oakland's deposits, received a transfer, the fact finder must determine whether the deposits were made in the ordinary course of business (Pet. A. 8). "A court must determine from *all the circumstances* whether the deposits were made in the regular course of business" in determining whether a set-off is a "transfer." (Pet. A. 9). Its conclusion that issues of fact are present which preclude summary judgment is a finding limited to the particular facts of this case.

Examination of "all the circumstances" surrounding the set-off shows that it is likely that these deposits were not made in the regular course of business. Summary judgment was thus improperly ordered by the District Court.

The account itself was not Oakland's ordinary business account, but was, instead, maintained as security for its loan from Glen Head.[6] The account was opened as a requirement to al-

[6] In *Citizens National Bank of Gastonia v. Lineberger*, 45 F.2d 522 (4th Cir., 1930), the court stated: "If there were showing that

lowance of the loan. When Glen Head learned that there were other substantial creditors in the picture, it demanded increased security in the form of compensating deposits which bore a relationship to the size of the loan.

The ordinary, daily business of Oakland was conducted not through its Glen Head account, but rather through its regular business account in the St. Clair National Bank of Belleville, Illinois. Between July, 1970 and May, 1971, Oakland made 112 deposits into its regular account there, and wrote 891 checks on the account. Those checks were drawn for the purpose of paying payables, taxes, ordinary operating expenses, and to transfer funds to the payroll account. The period between September, 1970 and April, 1971, immediately before the build-up, in the Glen Head account, was markedly less active. From January 1, 1971 to July 15, 1971, a period of six and one-half months, only three checks were drawn on the Glen Head Account, and two of those were to pay interest to Glen Head on Oakland's outstanding obligation.

The build-up was not made by Oakland in the regular course of its business. Indeed, by the time the Bankrupt began the build-up, it was virtually out of business. One month before the build-up began, in March, 1971, Oakland severely cut back its payroll; and the month it commenced the build-up, April, 1971, the factory had ceased to be a going concern and the office staff had been cut back. The next month, a second round of cut backs was made in the office payroll, the factory having ceased operations the previous month. Bank deposits made after a factory or business has ceased its operations are not made

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the deposits in question were made fraudulently or collusively, as a cloak for payments to the bank or as a means of giving it security, the trustee could avoid them under the Bankruptcy Act, without resort to the trust fund doctrine, if the bank were shown to have been a party *to the fraud or collusion, or to have accepted the deposits as a means of obtaining payment or security.*"

in the regular or ordinary course of business. *Merrimack National Bank v. Bailey*, 289 F. 468 (1st Cir., 1923); cert. denied 263 U.S. 704; *Cardozo v. Brooklyn Trust Co.*, 288 F. 333 (2d Cir., 1915); *Gates v. National Bank of Richmond*, 1 F. 2d 820 (D.C. Va., 1924); *Wilson v. Nebraska State Bank*, 126 Neb. 168; 252 N.W. 921, 24 Am. Bankr. Rep. N.S. 621 (1934) (Pet. A. 11).

Furthermore, Oakland instituted the build-up with the Glen Head Bank to protect Brede, since Brede had personally guaranteed the obligation, had pledged all the stock in his several companies to the bank as security on Oakland's loan, and since Brede had further mortgaged his home to the Bank to secure the loan. Even the District Court recognized that this was the reason the deposits were made (Pet. A. 24). Protection of a corporate officer's private finances is by no means a practice recognized as being one done in the ordinary course of business.

Nor was it the ordinary course of Oakland's business to make such large deposits in its New York account over such a short period of time, without making any withdrawals. Oakland deposited $108,732.07 in two and one-half months without writing a single check on the account. The bank paid no interest on deposits in this account. Examination of Oakland's prior banking practices reveals this to have been a highly unusual sequence of acts.

The trier of fact could easily conclude that the bank did not accept these deposits in the ordinary course of business. The account was maintained as security for the $125,000.00 loan. Knowing about Oakland's other creditors, including the Small Business Administration and the St. Clair National Bank, petitioner Glen Head asked, in 1970, that a substantial "compensating balance" be maintained in the account. The bank's president gave his reason for demanding this compensating balance:

> "to be sure that we weren't left out in the cold since we were extending substantial dollars, too."

Brede had been in close contact with the bank during the months immediately prior to the set-off. Conversations between the bank and both Brede and one of Oakland's employees had informed the bank of Oakland's worsening financial condition during those last few months.

Even before the loan was made, the bank knew of Oakland's financial problems. It loaned Oakland only half the amount it had requested, since Oakland had turned only losses during the eleven months prior to obtaining the loan, and made the loan not on Oakland's financial strength, but on Brede's. When the bank demanded additional collateral on the loan, it did so because of Oakland's continued inability to earn a profit. In June, 1970, the bank advised Oakland that it "want[ed] out." The bank's entire loan committee discussed Oakland's bleak financial picture, and the bank learned of Oakland's "adverse financial condition" as it received Oakland's periodic financial statements. The petitioner bank knew in early 1971 that Oakland had falsified its 1970 Dun & Bradstreet report.

A set-off made by a bank on its depositors' account which is made after the bank has stopped withdrawals on the account is not a transaction made in the ordinary course of business. *Mechanics & Metals National Bank v. Ernst*, 231 U.S. 60 (1913); *Irving Trust Co. v. Bank of America National Association*, 68 F. 2d 887, 890 (2d Cir., 1934). Here, the bank froze Oakland's account on June 29, 1971, immediately following Brede's phone call to Famighetti telling him that Oakland was in financial trouble, and that he was calling his other creditors in an attempt to work his way out. The very next day, the bank made the disputed set-off.

These facts show that the set-off and Glen Head's acceptance of the deposits were not necessarily made in the ordinary course of business. The Second Circuit recognized that many factual issues were present, noting that this record presents "such critical issues of fact as whether, in view of the build-up

and real nature of the Glen Head account, the bank acted in good faith in accepting the deposits", "whether the account in fact was a general deposit account," (Pet. A.3) and "whether the bank was aware of Oakland's intentional build-up of its account as reflected in the bank's acceptance of the deposits other than in the bank's regular course of business." (Pet A. 5). Proof of "Famighetti's continuous knowledge of the course of Oakland's accelerating financial difficulties and his communications with Brede," (Pet. A.7) held the court, would prove the bank's acceptance of these deposits outside its ordinary course of business. It was "to resolve these and other issues of fact"[7] that the court unanimously reversed and remanded.

Whether a normal debtor-creditor relationship was present was a factual question, not appropriate for disposition by summary judgment. Here the Trustee, in response to the Motion for Summary Judgment made by the bank, produced evidence that a unanimous panel of the Court of Appeals held would allow a conclusion that these deposits were neither made nor accepted in the ordinary course of business.

In summary, the Court of Appeals' holding was limited to the specific facts before it. The review of this decision by the United States Supreme Court would occasion no opportunity to consider any issue of general importance to bankruptcy jurisprudence. The petition for a writ of certiorari should therefore be denied.

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[7] The jury could well conclude on this record that the bank, in light of the extensive and detailed knowledge it had of the bankrupt's adverse financial circumstances, would not have allowed any withdrawals from this account during those final days. And even if it were to be concluded that these withdrawals would have been permitted, allowance of such withdrawals would not, alone, make mandatory a finding that there were no transfers. As the Court of Appeals below correctly recognized quoting *Merrimack National Bank v. Bailey*, 289 F. 468, 470 (1st Cir.), cert. denied 263 U.S. 704 (1923): "The fact that such bank creditors may honor checks on deposit does not control. In this case, checks to cover these deposits were not drawn and paid." (Pet. A. 8-9, n. 7).

II

The Majority's Decision Below Is Consistent With the Prior Holdings of This and Other Courts.

The Second Circuit majority, in its alternative holding, correctly recognized that a bank's set-off may be attacked as a voidable preference if the bankrupt deposited the funds in question other than in the ordinary course of its business, intending a transfer, and the bank had reasons to know, at the time the deposits were made, that the depositor was insolvent.

No case has held the regular course of business requirement to be applicable solely to the bank and no case has required that in order for a build-up followed by a set-off to constitute a transfer, the bank be an active participant in the build-up. A showing of a transfer within the meaning of the Act is made where the bankrupt's intention is to effect a preference, where, as here, at the time the deposits were made, the bank knew of the depositor's insolvency.[8]

The bank's argument that "a depository bank must be culpable in order for it to be held liable as the recipient of a preferential transfer" (Petition, p. 15) is an improper statement of the law. The Court of Appeals below correctly recognized that "a bank's participation in the build-up . . . is not a prerequisite to a finding that there has been a transfer." Rather, the intent of either the depositor or the bank to effect a transfer is sufficient to allow the conclusion that a transfer has been made. As the Court stated in *Cusick v. Second National Bank*,

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[8] There is no issue presented to this court respecting Oakland's insolvency. The trial court assumed Oakland was insolvent at the pertinent time and that the bank had reasonable grounds to so know (Pet. A. 21); the Court of Appeals recognized that "whether the bank had reasonable cause to believe that Oakland was insolvent is something that the trustee must prove at trial and is a question for the jury." (Pet. A. 13, n. 10).

73 App. D.C. 16, 115 F.2d 150 (1940), a deposit may be a preferential transfer if "either the [depositor] or the Bank, at the time of the deposits, intended them to operate as a payment of the notes," and that a deposit would not be a preferential transfer only "if both depositor and the bank intend" that it would be subject to withdrawal. In *Mayo v. Pioneer Bank & Trust Co.*, 270 F.2d 823 (5th Cir., 1969), the Court agreed, noting that the trustee could attack a set-off as a preference if "at the time of the deposits either the company or the bank intended them to operate as payment of the debt rather than as an ordinary deposit subject to the depositor's withdrawal."

The Court of Appeals below focused on the problem quite clearly, recognizing that the scope of inquiry must be consistent with the reasons for disallowance of set-offs in non-ordinary course transactions:

> "In deciding whether a bank's set-off is a 'transfer', a court must determine from all the circumstances whether the deposits were made in the regular course of business. In view of the purpose of the inquiry, it does not make sense to consider only the bank's course of business. If the deposits somehow are out of the regular course of the depositor's business, the bank's normal procedures or the usual course of dealings between the depositor and the bank, then an inference can be drawn that the deposits were not ordinary deposits but served to transfer the depositor's property to the bank. By limiting its inquiry to the regular course of the bank's business, the district court below failed to take into account that 'a deposit may be made the cloak for some other transaction, such as payment or the giving of security; and in such case equity, which looks through form to substance, will treat the transaction according to its real nature.' Citizens' National Bank of Gastonia v. Lineberger, supra, 45 F.2d at 527-28." (Pet. A. 9)

This Court recognized, in the leading case of *Studley v. Boylston National Bank*, 229 U.S. 523, 527 (1913), that the intention of a depositor alone to effect a preference is sufficient to allow a finding of transfer:

> "We find nothing in the record to indicate that the deposits were made for the purpose of enabling the bank to secure a preference by the exercise of the right of set-off. The case, therefore, comes directly within the decision in *New York County National Bank v. Massey*, 192 U.S. 138."

Thus, this Court recognized that *Massey* controls only in those cases where there is no evidence of record to indicate that the purpose of the depositors in making the deposits was to secure a preference, and spoke strictly of purpose of making deposits. No mention was made of purpose in accepting funds for deposit.[9] And this record is replete with facts showing Oakland's intent summarized in Section I above. Certainly a sufficient showing of the depositors intent to effect a preference was made to avoid summary judgment. Indeed, even the District Court recognized: "I have assumed that the deposits were not made by Oakland in the ordinary course of its business, but were instead made . . . to place funds within easy reach of the bank's right of a set-off." (Pet. A.24).

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[9] Indeed, *Massey* relied upon so heavily by the bank provides an excellent illustration of how properly to evaluate a fact pattern to determine whether the funds were deposited in the ordinary course of business. There the bankrupts, brothers doing business as a partnership, deposited $6225.25 between January 22 and January 25, into their regular business account. Subsequent to the deposits aforementioned but prior to being adjudicated bankrupt on January 27, the depositors wrote a check on their account which the bank honored. The Court of Appeals found that the deposits were made in the usual course of business. In holding that there had been no transfer, but only an ongoing traditional debtor-creditor relationship, this Court carefully noted:

> ". . . there is nothing in the finding to show that the deposit created other than the ordinary relation between the bank and its depositor. The check of the depositor was honored after this deposit [of $6225.25] was made, and for aught that ap-

The bank's contention that only where it is implicated may there be a transfer is unsound, pursuant to the Bankruptcy Act itself, as it confuses the requirements of §§ 60(a) and 60(b) of the Act. The matter is fully explained by the Court of Appeals below, in footnote 9 of its opinion, and need not be repeated here (Pet. A.12).

The rule stated in *Cusick* and in *Mayo* which those courts drew from *Studley* and *Massey*, finds support in the other courts which have had occasion to consider the issue. In *Hood v. Brownlee*, 62 F.2d 675 (4th Cir., 1933), the Court stated:

> "If the bankrupt himself had made the deposit with a view of giving the bank a preferential payment on its claim, the bank would not have had the right of set-off."

The disjunctive "or" was carefully used to distinguish between the intent of the depositor and the intent of the bank in *Joseph F. Hughes & Company v. Machen*, 164 F.2d 983, (4th Cir., 1947), cert. denied 333 U.S. 881. There, in the course of affirming a compromise between the Trustee and several creditors, the Court stated the rule:

> pears Stege Brothers [the bankrupts] might have required the amount of the entire account without objection from the bank, notwithstanding their financial condition."

The factors upon which this court relied in *Massey*, were the identical variables to which the Second Circuit looked in deciding this case. But here those factors presented a very different picture. In *Massey*, the Court looked at the nature of the account itself (which was the bankrupt's regular business account), the fact that a check was actually written by the bankrupts and honored by the bank after the deposits in question had been made, and the nature of the on-going relationship between the bank and the depositor. Here, instead of an ordinary business account, the account was maintained as security for a large loan, and indeed, the account was not even opened until the loan was made; size of deposits in the account were related not to the bankrupts' daily business needs, but rather were a "compensating balance", reflective of the obligation the bankrupt had to the bank. While here no checks were written, it is likely that had they been drafted they would have been dishonored during the final days before set-off.

> "Of course the application of these principles presupposes that there has been a bona fide deposit made in due course of business. *Thus where there has been a deliberate building up of an account for the purpose of enabling the bank to obtain a preference, or* where the deposit is accepted by the bank with the intent of applying it to the depositor's obligations rather than subjecting it to his power of withdrawal, an attempt on the part of the bank to set off the deposit will result in a preference as long as the other conditions of Section 60 are satisfied. *Rector v. Commercial National Bank*, 200 U.S. 420, 26 S.Ct. 294, 50 L.Ed. 533; *Mechanics' & Metals National Bank v. Ernst*, 231 U.S. 60, 34 S.Ct. 22, 58 L.Ed. 121; *Goldstein v. Franklin Square National Bank*, 2 Cir., 107 F.2d 393; *Twentieth Street Bank v. Gilmore*, 4 Cir., 71 F.2d 594; *Callaway v. West Palm Beach Atlantic National Bank*, 5 Cir., 69 F.2d 224, 225; *Frankford Trust Co. v. Comber*, 3 Cir., 68 F.2d 471; *Rupp v. Commerce Guardian Trust & Savings Bank*, 6 Cir., 32 F.2d 234. This result is reached because the apparent deposit is in fact a payment to the bank and the bankruptcy court will look through form to substance and treat the deposit as a transfer of property for or on account of an antecedent debt. *Mechanics' & Metals National Bank v. Ernst*, 231 U.S. 60, 34 S.Ct. 22, 58 L.Ed. 121; *Frankfort Trust Co. v. Comber*, 3 Cir., 68 F.2d 471; *Matters v. Manufacturers' Trust Co.*, 2 Cir. 54 F.2d 1010." 164 F.2d 987, 988. Cert. denied 333 U.S. 881. (Emphasis supplied.)

The same rule was stated in *Citizens National Bank of Gastonia v. Lineberger*, 45 F.2d 522 (4th Cir., 1930); *Bank of Commerce & Trusts v. Hatcher*, 50 F.2d 719 (4th Cir., 1931); *Blue v. Herkimer National Bank*, 30 F.2d 256 (2d Cir., 1929); *Goldstein v. Franklin Square National Bank*, 107 F.2d 393 (2d Cir., 1939); *Frankford Trust Co. v. Comber*, 68 F.2d 471 (3d Cir., 1933); *In re Almond-Jones Co.*, 13 F.2d 152, 157 (1926),

affirmed sub. nom. *Union Trust Co. v. Peck*, 16 F.2d 986 (4th Cir., 1927).[10]

The holding of the majority below conforms fully to the holdings of both this Court and the holdings of the Courts of Appeal which have had occasion to consider the question. None of the circumstances enumerated in Supreme Court Rule 19 are present. The writ should therefore be denied.

III

The Decision Below Fully Complies With the Proper Standards for Review of Summary Judgment Proceedings.

The bank's final argument, respecting the showing necessary to defeat a Motion for Summary Judgment, is nothing more than creation of a straw man and a demonstration to this Court that it can blow him down.

While Glen Head correctly quotes the Court of Appeals in its several references to the Trustee's "allegations," it attempts to mislead this Court by suggesting that the Court's references to "allegations" were to allegations from the Trustee's pleadings

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[10] The bank's reliance upon *Farmer's Bank of Clinton, Missouri v. Julian*, 383 F.2d 314 (8th Cir., 1967) is misplaced. The Court of Appeals properly distinguished that case as having involved a long-standing active account in which withdrawals and deposits were made every day, and having presented no evidence of either the bank or depositor acting rather than in the ordinary course of business. The decision of the referee that the deposits were made by "pre-arrangement" was reversed as being contrary to the evidence. Likewise, *Plymouth County Trust Co. v. MacDonald*, 60 F.2d 94 (1st Cir., 1932) provides no comfort for defendant. There the bank was the one with which the bankrupt conducted all of its routine business, and the deposits were made subject to check. Even the depositor did not intend a transfer. Yet as to a substantial portion of the deposits there, even though the bankrupt had not intended a transfer, the court found one because of the bank's intent in accepting the deposits. No collusion between the parties was deemed necessary.

(Petition, p. 26). But the "allegations" referred to by the Court of Appeals are all, and without exception, inferences premised upon specific facts specifically proven by the Trustee in his answering papers to the Bank's Motion for Summary Judgment. Those facts are set forth in detail in respondent Trustee's statement of the case above.

An example will suffice to show that the Trustee's "allegations" are all firmly rooted in the record which the Second Circuit had before it on review.

All of the Trustee's "allegations" respecting Famighetti's knowledge of Oakland's financial plight were drawn from Famighetti's own deposition. For example, Famighetti testified respecting his knowledge of Oakland's continuing losses.

> Q. When were you first aware, if at all, of Oakland's adverse financial condition, if you were ever aware of it?
>
> A. Well, just as the statements were coming in, there was a loss history. So I felt that they were always in——
>
> Q. In adverse condition?
>
> A. Yes.

Elsewhere in the deposition, Famighetti testified as follows, respecting a bank memo of June, 1970, a year before the set-off:

> Q. Referring to Plaintiff's Exhibit 19, there is reference to the defendant being aware that Mr. Brede was not in a position to pay off the debt in mid-1970.
>
> Do you see that on the first page?
>
> A. In the front?
>
> Q. Right. The first line.
>
> A. Was not in a position to——

Q. It says, "As expected." Was that expectation based upon an oral conversation which you had with Mr. Brede prior to that time or just based upon the financial statements that you had received up to that time or both?

A. It was based on my opinion from the experience with the loan.

Q. Well, what facts was your opinion based upon other than the financial statements sent to you by Oakland since the inception of the loan and the trucking strike that you referred to?

A. Yes, well, from what I could see.

Q. Well, what did you see?

A. From the fact that it was a continuously loss operation, could hardly expect that he would make a substantial payment.

Q. Unless he went to someone else——

A. Some other source.

Q. Were you advised that he was attempting to obtain monies from another source in order to repay the instant loan?

A. I was not aware of it, no.

Q. Now, on the back of that memorandum, there is a reference here to the "bank want(ing) out", with the brackets around the "i-n-g".

Are those the words that the bank said to Mr. Brede?

A. I don't—these would have been my words and I don't believe I used exactly those words.

It is an expression, let's say, within the industry "We want out." And this is essentially——

Q. Well, the words are in quotations and I take it they are in quotations because of the vernacular as opposed to what was actually said.

A. I would have implied as much.

Q. Have you stated the reason why the bank wanted out this morning and in your prior deposition, would you have stated additional reasons at or about the time you made this memorandum?

A. I think I stated earlier in the sense that we expected our time loan to have been paid out at maturity, its anniversary. That did not occur, of course.

Similar evidence in support of all of the Trustee's other factual "allegations" made in the Statement of the Case above respecting the bank's knowledge and its communications with Brede may be found in the record. Only by closing its eyes to the record is Petitioner able to argue the absence of evidentiary support for the Court of Appeals' decision. Insofar as the bank takes issue with the weight and strength of some of the evidence, those arguments are inapplicable in summary judgment proceedings.[11]

The bank next cites cases which hold that an affidavit of counsel not made upon personal knowledge, will not defeat a

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[11] In ruling on a Motion for Summary Judgment, the Court must construe all matters in favor of the opponent of the Motion, and all favorable inferences which can be drawn from his papers should be so drawn. *Adickes v. S. H. Kress Co.*, 398 U.S. 144 (1970); *U. S. v. Diebold, Inc.*, 369 U.S. 654, 655 (1962). Further, facts asserted by the opponent of the Motion are regarded as true. *First National Bank of Cincinnati v. Pepper*, 454 F.2d 626 (2d Cir., 1972). And where the issue at bar is the credibility of one interested witness such as Famighetti, the case must be tried. *The Conqueror*, 166 U.S. 110; *Sonnentheid v. Christian Moerkin Brewing Co.*, 172 U.S. 401. Wright and Miller, Federal Practice and Procedure, §2727, pp. 530-531. The Affidavit of the Trustee's counsel alone was sufficient to create a jury question as to credibility, *Sartor v. Arkansas Natural Gas Corp.*, 321 U.S. 620 (1944). And here far more evidence than just the affidavit was tendered.

Motion for Summary Judgment. The Trustee agrees. But the affidavit of counsel submitted in this cause *was* made upon personal knowledge, and an affidavit of counsel based upon personal knowledge is proper under F.R.Civ. P. 56(e). Wright and Miller, Federal Practice and Procedure, § 2738, p. 699; Moore's Federal Practice, § 56.22(1), p. 56-1320-21; *Stephens v. Brown & Root, Inc.*, 338 F. Supp. 680, affirmed 455 F.2d 1383 (5th Cir., 1972); *Douglas v. Beneficial Finance Co.*, 334 F. Supp. 1166 (D.C. Alaska, 1971) reversed on other grounds 469 F. 2d 453 (9th Circ., 1972).

Contrary to the argument of Glen Head, the Second Circuit has not engrafted an exception to the Federal Rules of Civil Procedure. Your Respondent, the Trustee, responded to the bank's Motion for Summary Judgment with substantial, powerful evidence. The Second Circuit held the Trustee entitled to his day in court because he produced probative evidence which defeated that motion. No new standard has been stated for Summary Judgment proceedings in Trustees' suits. The Court merely applied the well known standards for review of Summary Judgment proceedings to the facts before it. It is only by disregarding those facts that Glen Head is able to argue that the Court of Appeals erred.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1977

No. 77-918

THE FIRST NATIONAL BANK OF GLEN HEAD,

Petitioner,

v.

DONALD KATZ, Trustee in Bankruptcy of Oakland Foundry Company of Belleville, Illinois, Inc.,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONER'S REPLY MEMORANDUM

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

Cases:

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PETITIONER'S REPLY MEMORANDUM

The First National Bank of Glen Head (the "Bank"), the petitioner herein, replies to the opposing brief filed by the respondent, Donald Katz (the "Trustee"), trustee in bankruptcy for Oakland Foundry Company of Belleville, Illinois, Inc. ("Oakland").

I.

THE TRUSTEE'S DISTORTION OF THE RECORD

The Nature of the Glen Head Account. The Trustee asserts, without any foundation in the record, that the account maintained at the Bank (the "Glen Head account") was not an "ordinary business account, but was, instead, maintained as security for" the Bank's loan to Oakland. Opp. Brief, at 14-15. The Trustee, however, ignores his admission (Joint App., at 31) of the following facts in the record below:

> "10. Oakland used the Glen Head Account in the normal course of its business, paying its accounts payable on a regular basis from that account. Brede Testimony, at 9. In fact, from January 6, 1970 (until April 15, 1971, 'at least 260 checks' were drawn on the account, and from January 6, 1970 until October 1, 1970, only six of these checks were made payable to the Bank, and these were for federal

taxes. Plaintiff's Response Nos. 4, 5 and 6 to Request for Admissions.

> "11. The balance in the Glen Head Account fluctuated.... In July of 1969, for example, there were deposits of $18,012.05; the account opened that month with a balance of $11,638.84, but ended the month with a balance of $24,929.68. In August of 1969, there were deposits of $33,511.23, and the balance at the end of the month was $24,185.44. In September of 1969, there were deposits of $34,439.39, and the balance at the end of the month was $16,950.54. A similar pattern of activity continued until October of 1970. From October 1970 through March 1971, the account was less active and had lower balances...."

Joint App., at 27.

The Communications Between Oakland and the Bank. The Trustee charges that "Brede [the guarantor-principal of the bankrupt] had been in close contact with the Bank respecting Oakland's obligation to the Bank during the few months immediately preceding the set-off," and that "the Bank began asking that a

substantial 'compensating balance' be maintained...." Opp. Brief, at 8-9. Nothing in the record supports these charges, however. Although the Bank may have been skeptical about Oakland's financial condition,* nothing in the record shows that the Bank "had been in close contact" with Brede or any other representative of Oakland. Indeed, the Trustee never offered an affidavit or the deposition testimony of any person with personal knowledge of the facts to support his allegation.

The only knowledgeable officer of the Bank testified at his deposition as follows:

> "Q. Did you have any understanding with Mr. Brede with respect to those deposits on the part of Oakland?
>
> A. None whatever.

---

* Even if the Bank had knowledge of insolvency, which was not proved, that does not deprive a bank of its right of set-off. Plymouth County Trust Co. v. MacDonald, 60 F.2d 94, 96 (1st Cir. 1932); Citizens Nat'l Bank v. Lineberger, 45 F.2d 522, 530 (4th Cir. 1930) ("...such knowledge does not show collusion. ...").

Q. Did you have any conversation with Mr. Brede in that regard?

A. No.

* * *

Q. These monies were deposited with your knowledge or without your knowledge at the time they came in?

A. Without my knowledge.

* * *

Q. Well, did you have any conversations with [Brede] in this regard?

A. No.

Q. He did not at this time travel between Belleville, Illinois and his home in...New York?

A. This I don't know. But he didn't stop in to see me or call or see me."

Joint App. at 136-37.

In response to questions asked by the Trustee's counsel, Brede, president of Oakland, also testified under oath in the bankruptcy court as follows:

"Q. During the months prior to bankruptcy had you been in contact with The First National Bank of Glen Head concerning your sale of the building?

A. No. About the only contact I had was right towards the end in June or July. I got all the people together here in Belleville and told them that we were in financial trouble and I called the bank up in New York and told them that we were in financial trouble."

Joint App., at 190. Thus, the only two persons with knowledge of the facts contradict the Trustee's unfounded charge.

The Bank's Purported Knowledge. The Trustee also asserts that the Bank "had full knowledge of the character of the [activity] in Oakland's account.... Famighetti [the Bank's president] admitted observing the build-up himself, and the Bank knew how few withdrawals were being made on the account, knew the nature of at least some of those withdrawals, since most were to pay interest to the Bank itself, and knew that such was not the pattern of an ordinary business account." Opp. Brief, at 12-13. Again, there is nothing in the record to support these charges. The following excerpt from

the record, taken from the deposition of the Bank's president, discloses the real nature of the Bank's knowledge:

> "Q. Did anyone bring to your attention the fact that within a space of a two-or three-month period there was a $100,000 build-up of deposits?
>
> A. Not particularly to that amount. It was my own observation. We have a periodic indication of the deposits on hand. When they rise above the $25,000 level and these reports will flow through so we have a better sensing of our companies, and suddenly I saw that balance appear which indicated that deposits were being made.
>
> Q. To the extent that I have gone into?
>
> A. No. Just that it was an increase. I can recall thinking, well, he [Oakland] has turned the corner and I was happy to see it.
>
> Q. Well, did you have any conversations with him in this regard?
>
> A. No."

Joint App., at 137.

The Status of the Funds in the Glen Head Account Prior to Set-Off. According to the Trustee, "it is likely that had [checks] been drafted [against the Glen Head account] they

would have been dishonored [by the Bank] during the final days before set-off." Opp. Brief, at 22 (continuation of n. 9 from p. 21). This assertion is not only speculative, but also without factual basis. It was not until June 29, 1971, one day before the set-off that the Bank "placed a freeze on Oakland's account barring all withdrawals." Opp. Brief, at 13. Moreover, in the court below and in the district court, the Trustee admitted that Oakland could withdraw funds from the Glen Head account at will. Joint App., at 35, 40 ("The Glen Head Account was a general account, and there were no restrictions on Oakland's right to make withdrawals."). Significantly, the Trustee does not deny that a judgment or attachment creditor of Oakland could have reached the funds on deposit in the Glen Head account at any time prior to the Bank's set-off on June 30, 1971. Petition, at 11-12.

The Trustee's Response to the Bank's Motion for Summary Judgment. The Trustee also claims that he "responded to the bank's motion for Summary Judgment with substantial, powerful evidence." Opp. Brief, at 28. The affidavit submitted by the Trustee's counsel, however, was the only affidavit relied on to oppose summary judgment. More importantly, the substance of the lawyer's affidavit can be summarized as follows:

> (a) He "took possession of all books and records on the [bankrupt's premises]." Joint App., at 32.
>
> (b) Certain records "were under [his] direction, supervision and control...." Id.
>
> (c) He "caused a search to be made of the law records of lawsuits filed... against the bankrupt to determine whether there were outstanding judgments or lawsuits pending...from January 1, 1971 through July of 1971," and that "a search disclosed" only one suit.

Joint App., at 33. Thus, nobody with personal knowledge of the facts has even raised an issue as to (a) whether the Bank dealt in bad faith in accepting Oakland's deposits, (b) whether the

Bank was aware of an intentional build-up, or (c) whether withdrawals from the Glen Head account were restricted in any way. The documents in the record tend to show, at most, that Oakland intended to deposit funds in the Glen Head account. Nothing even tends to implicate the Bank. See, Modern Home Institute, Inc. v. Hartford Acc. & Indemnity Co., 513 F.2d 102, 109-10 (2d Cir. 1975) ("If the most that can be hoped for is the discrediting of defendants' denials at trial, no question of material fact is presented."), citing First National Bank v. Cities Service Co., 391 U.S. 253, 290 (1968).

The Bank's Acceptance of Oakland's Deposits. According to the Trustee, it could easily be found that the Bank "did not accept these deposits [from Oakland] in the ordinary course of business;" the Bank's "compensating balance" requirement is cited as proof. Opp. Brief, at 16. Compensating balances are typically required, however,

when a bank loans money to a small business. See App. I, at 16-17. Congress recognized this fact within the past year when considering bankruptcy reform legislation. H.R. Rep. No. 595, 95th Cong., 1st Sess. 184-86 (1977) ("In order to encourage a bank to carry a debtor through difficult times without the threat of losing a setoff right after bankruptcy, it may be desirable to permit ... bank setoff in any event.") (discussed at pps. 25-26 of the Petition herein). See also, Justman, "Comments on the Bank's Right of Setoff Under the Proposed Bankruptcy Act of 1973," 31 Bus. Law. 1607 (1976).

II.

THE UNDISPUTED CONFLICT WITH
THE DECISIONS OF OTHER CIRCUITS

The Trustee does not deny that the Second Circuit's decision conflicts with Citizen's Nat'l Bank v. Lineberger, 45 F.2d 522 (4th Cir. 1930). In that case, the evidence was undisputed that there had been communications between the bankrupt's principal guarantors and the president of the defendant bank, who was the brother-in-law of one of the guarantors, before deposits were made in the bankrupt's account. 45 F.2d at 523-24. Although no such evidence exists here, the Trustee avoids discussing the facts of Lineberger, obviously because there is a conflict between the Second and Fourth Circuits. See Petition, at 16-18.

The Lineberger decision, supra, was premised on this Court's decision in New York County Nat'l Bank v. Massey, 192 U.S. 138 (1904), which imposed a "fraud or collusion" requirement that the Trustee ignores. The Trustee's attempt to distinguish Massey from this case (Opp. Brief, at 21-22) is hardly convincing, and is inaccurate, as shown above.

Most of the Trustee's objections to the Bank's set-off here were made long ago by the late Professor MacLachlan and the National Bankruptcy Conference, but were rejected by Congress. Professor MacLachlan described the problem as follows:

"The existence of the banker's right to set-off his liability on the deposit against the debts of the depositor to the bank means that the deposit may be regarded as part of the banker's security. Hence, deposits made while the depositor is insolvent and the banker has reasonable cause to believe it, are transfers securing the bank, the effect of which will enable the bank to get a greater percentage of its debt than other general creditors. If the bank is already otherwise fully secured, so resort to the deposit is unnecessary, the question will not arise, but the question has frequently arisen when a deposit goes to increase the security of the bank where other security is inadequate. The banks in such cases have generally maintained successfully that when the deposit was made the depositor intended to have it available to pay his bills, just the way bank accounts are commonly used, and that the bank accepted it with the understanding that it was just like any other deposit.

"The acceptance of this view has been carried so far as to protect the bank after the debtor had circularized his mercantile creditors proposing a 25% composition, and stating that pending a creditor's meeting the assets will be preserved in the interest of creditors, and that any attempt by a creditor to obtain a preference by legal proceedings or otherwise would precipitate insolvency proceedings. On the day of the adjourned creditors' meeting the petition in bank-

ruptcy was filed, and the bank then appropriated the deposits made in the meantime to the payment of the debtor's obligation to it. During this interval the bankrupt withdrew no checks in favor of mercantile creditors. [Citing Massey and Lineberger, supra.] The court achieved this result by following the doctrine announced by the Supreme Court in such cases that making a bank deposit is not a transfer. Pragmatically, however, a bank deposit may and usually does, if the banker is alert, create a security for the bank. For all that appears, the depositor is free to withdraw the deposit anytime after he makes it, but if bankruptcy or insolvency in the commercial sense intervenes, the bank will extinguish the account by way of enforcing a set-off. True, the cases do not permit the bank to apply and retain deposits for a special purpose or deposits made pursuant to an agreement between the bank and the depositor that the account be built up while other creditors are kept waiting, but the mere fact that such a result was achieved is considered insufficient evidence of an agreement to that effect, and more specific evidence is frequently not forthcoming. The close working relations frequently maintained between a bank and its commercial depositor may hinder the proof of any definite agreement to prefer the bank.

* * *

"In the light of these considerations the National Bankruptcy Conference approved, as part of its drafts of the Chandler Bill, a proposed amendment to section 68 directed at covering the converse case to that covered in section 68b. That is, it dealt with transactions whereby a creditor of the bankrupt becomes the bankrupt's debtor with a view to set-off within four months of bankruptcy, and with knowledge or notice that the debtor is insolvent or has committed an act of bankruptcy. The proposal further specifically referred to bank deposits made under such circumstances that other transfers would be voidable preferences and proscribed set-off in such cases.

"It is not surprising that banker opposition caused the amendment to be stricken from the Chandler Act."

MacLachlan, Bankruptcy §§ 291-92, at 342-43 (1956)(citations omitted). In sum, the purported problem cited by the Trustee has already been called to the attention of Congress. The Second Circuit should not have attempted to change the applicable law* when at least two

* That the district court's decision represents the applicable law is reflected in a newly released law school publication, D. Epstein & J. Landers, Debtors and Creditors, 474-78 (1978), in which the authors reproduce the text of the opinion (App. II, at 18-26) and approve its reasoning.

Congresses, recognizing the benefits of the right of set-off, have refused to do so.

III.

THE TRUSTEE'S PURPORTED AUTHORITIES

The cases cited by the Trustee are easily distingishable. They confirm that a bank must be culpable in order for it to be held liable.

Merrimack Nat'l Bank v. Bailey, 289 F. 468 (1st Cir.), cert. denied, 263 U.S. 704 (1923) (Opp. Brief, at 16), is distinguishable because the bankrupt "was being liquidated by its creditors; naturally enough, the proceeds of liquidation were being deposited in various creditor banks. The understanding that no preferences should be given was, in effect, nothing but a recognition of the requirements of the law." 289 F. at 470. Unlike this case, the defendant bank knew all of the details of the bankrupt's financial condition and understood

the restriction on the deposited proceeds prior to accepting the deposits from the bankrupt. 289 F. at 469.

In Gates v. First Nat'l Bank, 1 F.2d 820 (E.D. Va. 1924) (Opp. Brief, at 16), deposits were made after the bankrupt suspended operations, and the defendant bank had full knowledge of this fact, primarily because an officer of the bank had been chairman of a creditors' committee. According to the court, the "[bank's] receipt of money ... was with unmistakable knowledge of bankruptcy," and the bankrupt's deposits were not "made in the ordinary course of business." 1 F.2d at 823-24. The Bank had no such knowledge here and had neither solicited nor participated in the build-up of the Glen Head account.

Likewise, in Wilson v. Nebraska State Bank, 126 Neb. 168, 252 N.W. 921 (1934) (Opp. Brief, at 16), an insolvent manufacturer, "with the knowledge, advice and approval of the managing officers" of the defendant bank,

sold certain assets for the purpose of liquidating its affairs. 525 N.W. at 922. One day after the sale proceeds were deposited with the bank, it set off such funds against an outstanding debt of the bankrupt. Id. No such knowledge existed here prior to Oakland's deposits, however, and Oakland's deposits were numerous and frequent. Joint App. 23, 27, 31.

Similarly, in Irving Trust Co. v. Bank of America Nat'l Ass'n, 68 F.2d 887 (2d Cir.), cert. denied, 292 U.S. 628 (1934) (Opp. Brief, at 17), the bank "had no right of set-off because the deposit was received after it had reason to know of the bankrupt's insolvency and after it had forbidden withdrawals from, or certifications against, the bankrupt's account." 68 F.2d at 890 (emphasis added). Here, however, the Bank had imposed no restrictions on Oakland's account, having learned of Oakland's financial problems for the first time on June 29, 1971, after the

deposits had been made by Oakland. Joint App., at 170-71, 190-91. The Bank set off here only after it acquired notice of a problem. App. at 23, 190-91. And in Mechanics' and Metals Nat'l Bank v. Ernst, 231 U.S. 60 (1913) (Opp. Brief, at 17), "[t]he so-called deposit of $54,048.08 was paid in after the cashier had forbidden the payment of checks against the deposit account and therefore rightly was held to be a payment and a preference. A set-off was properly denied." 231 U.S. at 67. Such facts do not exist here.

The Trustee's reliance on Cusick v. Second Nat'l Bank, 115 F.2d 150 (D.C. Cir. 1940) (Opp. Brief, 19-20), is also misplaced. That case merely dealt with whether the defendant bank "had reasonable cause to believe, at the time of the deposits, that payment of the notes would effect a preference, i.e., reasonable cause to believe that the [bankrupt] was then insolvent in the

bankruptcy sense." 115 F.2d at 152. The issue here, however, is not whether the bank had "reasonable cause" to believe Oakland insolvent but whether the Bank "acted in good faith in accepting the deposits or whether the [Glen Head account] in fact was a general deposit account." App. I, at 3.

In Mayo v. Pioneer Bank & Trust Co., 270 F.2d 823 (5th Cir. 1959), cert. denied, 362 U.S. 962 (1960) (Opp. Brief, at 20), the proceeds received on a contract were immediately transferred by the bankrupt by means of a debit memorandum "solely to repay the loan" from the defendant bank which had reasonable cause to believe the depositor to be insolvent at that time, "and the depositor was in fact insolvent." 270 F.2d at 836. No such evidence exists here.

Blue v. Herkimer Nat'l Bank, 30 F.2d 256 (2d Cir. 1929) (Opp. Brief, at 23), is easily distinguishable. There, the moneys

were collected and deposited by the defendant bank in a special bank account "for the purpose of" being applied against the maturing notes of the bankrupt. 30 F.2d at 259.

> "It [the bank] had full knowledge of the bankrupt's financial condition from the statement furnished, and from its method of handling his moneys when received in payment of the contract it displayed a desire to protect itself. To a considerable extent, the defendant took supervision of his finances in carrying out his contracts. It had reasonable cause to believe that it was obtaining an advantage over the creditors, and is chargeable with the intent of creating a preference for itself."

30 F.2d at 260. The Bank here, however, had no control over the business or the checking account of Oakland. Indeed, the Trustee has admitted that the Glen Head account was of a general, unrestricted nature. Joint App., at 22, 30.

In In re Almond-Jones Co., Inc., 13 F.2d 152 (D. Md. 1926), aff'd sub nom. Union Trust

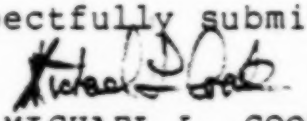
Co. v. Peck, 16 F.2d 986 (4th Cir.), cert. denied, 273 U.S. 767 (1927) (Opp. Brief, at 23), "both the [defendant] bank and the bankrupt ... intended ... that the deposits should be applied [by the bank]...." 13 F.2d at 157. The Bank had no such intent here when Oakland made its deposits, and none has been shown.

CONCLUSION

The need for plenary review of the decision below is indisputable. Indeed, the Trustee does not deny that this Court and other circuit courts have imposed a requirement of "fraud or collusion" between the bankrupt and the bank, or at least some culpable act by the bank, to deprive it of its recognized right of set-off. The Trustee's

fictionalization of the record below should not preclude this Court's review of a decision that will have an adverse effect on all financially troubled businesses.

Respectfully submitted,



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